

# **NAVAL POSTGRADUATE SCHOOL MONTEREY, CALIFORNIA**



## **THESIS**

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**IMPACT OF ZIMBABWE - SOUTH AFRICA  
TRADE RELATIONS: A BILATERAL,  
REGIONAL, OR MULTILATERAL APPROACH?**

by

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June 1997

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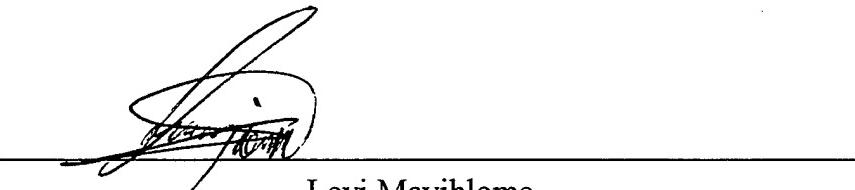
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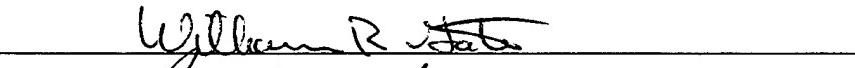
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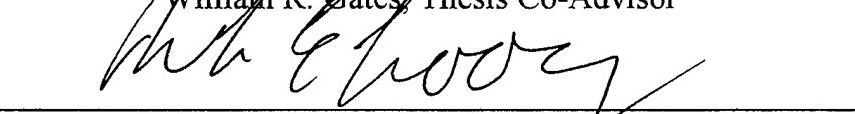
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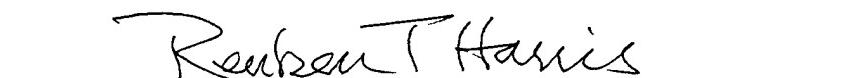
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## ABSTRACT

The pursuit of a seemingly unfruitful bilateral trade arrangement with South Africa, and continued participation in overlapping, but non-functional regional free trade areas, has left Zimbabwe in foreign trade dilemma, specially in the light of the deteriorating terms of trade with South Africa, her main trading partner and competitor for both mutual and regional trade.

This thesis examines the various regional trade possibilities involving Zimbabwe and South Africa using the free trade area and customs union models of international trade. Whereas a functional bilateral trade agreement or a regional customs union culminating in a common market might improve Zimbabwe's regional competitiveness in the short run, due to South Africa's economic dominance and protectionist trade policies, Zimbabwe's potential to benefit from trade with non-participants would be severely curtailed. However, a broad free trade area, which allows flexibility to pursue national trade policies, seems less harmful. The analysis concludes that only a broad free trade area superseding all current eastern and southern African regional trade arrangements would increase Zimbabwe's economic welfare. It would be in the interests of all regional countries to finalize a single broad free trade area rather than maintain the status quo.



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This thesis is dedicated in part, to my late brothers Isaiah and Josphat. Things could have been much better with you around. More importantly, I dedicate the thesis to my wife, Getrude and children Butholezwe, Nomagugu, Silungile and Kwanele, who were the only reason for my sleepless nights, and *whom I challenge to better my record.*



## I. INTRODUCTION

One feature of the international trading system since the 1980s has been the proliferation of regional trading arrangements in the form of preferential trade areas, free trade agreements, customs unions and common markets. While economic forces have internationalized markets, technology and investments, the same forces appear to have helped expand regional trading blocs. The current wave of regional trading arrangements, particularly in the lesser developed countries (LDCs), differ from the earlier efforts in the 1950-60s. These earlier efforts were driven by import substitution; the more recent trends tend to be export oriented and seek to attract foreign investment.

The rationale of regional arrangements is both economic and political. On the economic level, they expand trade, expand economies of scale, increase welfare through trade creation or by substituting lower cost imports for domestic and regional production, and counteract possible protectionism in the export markets. On the political front, there have been arguments that regional trading arrangements strengthen the negotiating leverage of the group vice outsiders and promote regional cooperation. At independence, many developing countries saw economic integration as a way of reducing dependence links with former colonial countries. Regional solutions were associated with attaining economic independence, development and self-reliant industrialization.

However, economists and policy makers alike are divided on the wisdom and utility of regional trading agreements. One school of thought argues that trading blocs reduce potential world welfare through trade diversion, beggar-thy-neighbor trade policies and aggressive protectionism and tend to frustrate global liberalization of trade. The other view is that global negotiations are slow in resolving trade issues. One reason cited for this trend has been the frustration at the slow opening up of

export markets, and delayed conclusion of General Agreements on Tariffs and Trade (GATT) and World Trade Organization (WTO) negotiations. Regional trading agreements proved useful in addressing issues that GATT and the WTO failed to resolve. Furthermore, GATT has failed to provide realistic solutions to international trade problems, hence countries need to work out alternative welfare maximizing solutions.

The turmoil in GATT in the 1970s, trade restraints as a result of recession and subsequent crippling oil crises-induced debt spurred the trend toward regional trade agreements. The inextricable nature of macroeconomic factors from microeconomic issues or industrial structures also created global imbalances as countries tried to respond to the international trade and financial crises.

Like most LDCs, Zimbabwe's experience with regional trading arrangements has been mixed. In 1964, South Africa and Zimbabwe (formerly Rhodesia) signed a formal bilateral preferential trading agreement on a most-favored nation status, allowing unrestricted access to Zimbabwe's exports in certain sectors, (radios, footwear, clothing and textiles, and agricultural products). On the other hand, South Africa enjoyed access to the region's second most developed market for an array of consumption goods, as well as agricultural, mining and industrial production inputs. South Africa became Rhodesia's largest trading partner, for both exports and imports, thanks to the 1964 Preferential Trade Agreement and the UN sanctions between 1965-1980. At the same time, Zimbabwe (apart from Mauritius) is arguably South Africa's main competitor for light manufactured exports to the southern-African region.

The main problem facing Zimbabwe has been the growing trade deficit with South Africa, its largest trading partner, largely due to increasing protectionist tendencies and unilateral actions in amending the 1964 trade agreement for its own interests. In 1992, South Africa unilaterally "canceled" the trade arrangement, and slapped Zimbabwean textiles with a 90% import tariff. South Africa's cancellation

of the preferential trade agreement affected many sectors, particularly Zimbabwe's textile and clothing industries. The agreement has increasingly favored South Africa at the expense of Zimbabwe, which has never attempted to invoke measures to safeguard its interests for fear of triggering a trade war. Despite close political ties with the new South African government, renewing the preferential bilateral trade arrangement has proven difficult.

Concurrently, the southern African countries have been transforming the Southern African Development Coordinating Conference (SADCC) into a regional trade agreement, called the Southern African Development Community (SADC). SADC seeks among other things, to have a free trade area by 2005. This, it has been argued, would obviate the need for bilateral agreements between the countries. South Africa has also entered into a series of competing bilateral trade agreements with Zimbabwe's neighbors. In theory, South Africa has closed the potential (Zimbabwe's) for free trade in the region due to these bilateral and multilateral agreements.

Two other important developments have occurred in Southern Africa since the 1980s. The first development is the overlapping membership of SADC and the Common Market for Eastern and Southern African States (COMESA). Zimbabwe is a founding member of COMESA, but South Africa is not a member. COMESA was formed in the early 1980s as a Preferential Trade Agreement (PTA). Its membership includes 20 countries from as far north as Djibouti and Ethiopia. Of the twelve SADC members, only two are not members of COMESA. In addition, five out of twelve are also members of another higher-level regional grouping, formed in 1910, called the Southern African Customs Union (SACU). The second major development is the recent announcement by the European Union (EU) and South Africa that they intend to start negotiating toward establishing a free trade area, excluding all of South Africa's colleagues in both SACU and SADC.

Analyzing the impact of the problems relating to the bilateral trade agreement and the overlapping regional trade arrangements, all at different levels of integration, could reveal how Zimbabwe can extricate herself from this external trade dilemma. It will be argued that, political reasons aside, a bilateral trade arrangement with South Africa will entrench that country's trade advantages over Zimbabwe. Furthermore, neither a customs union, nor overlapping regional trade arrangements will optimize benefits to Zimbabwe, let alone the region as a whole. Zimbabwe could increase its welfare by concentrating on a free trade agreement with all the countries of southern Africa, including South Africa, rather than pursuing individual bilateral agreements. Individual agreements will compete with other bilateral arrangements that South Africa has or is trying to negotiate. Overlapping regional trade arrangements will increase protectionism, thus delaying broader trade liberalization in the sub-continent. Finally, while a customs union might maximize welfare for South Africa, a free trade arrangement would maximize Zimbabwe's economic welfare.

This thesis will use information from published sources on both the historical economic development of Zimbabwe and South Africa, and microeconomic and international economics/trade, with particular emphasis on bilateral trade and regional economic groupings. Macroeconomic indicators and trade statistics of the two countries will also be examined. While the relations between countries are influenced by economic, political and social variables, this thesis does not examine political and social issues, or analyze the impact of macroeconomic policies. It will be restricted to microeconomic factors and trade policies which promote or restrict mutually beneficial trade.

The economic impact of the Zimbabwe-South Africa trade disagreements and the effect on Zimbabwe's welfare gains will be examined in the context of:

- ◆ A Southern African free trade area vice harmonizing into a customs union.

- ◆ Bilateral trade arrangements with her neighbors.
- ◆ Choosing between SADC and COMESA, or catalyzing the amalgamating of the two overlapping organizations into a broader free trade area.

The utility South Africa derives from this trade restriction strategy will be examined. Specifically, the following questions will be addressed:

- ◆ To what extent have South Africa's strategies trade Africa affected Zimbabwe's economy and external trade competitiveness?
- ◆ Given the historical background of the Zimbabwe-South Africa bilateral trade agreements, what are South Africa's incentives to both procrastinate its decisions on the preferential trade agreement with Zimbabwe, and defer implementing the SADC Trade Protocol.
- ◆ What are the alternatives to Zimbabwe's continued dependence on trade with South Africa?
- ◆ In terms of contemporary trade theories, what benefits is Zimbabwe likely to derive from (1) bilateral trade agreements with its major trading partners, including South Africa; (2) a regional free trade agreement including South Africa, culminating in a common market; and (3) liberalizing trade to cover both COMESA and SADC and the rest of the world.

The study will be organized as follows:

Chapter II will outline the theoretical foundations of international trade and regional trading arrangements. It will then look at the origins of the multilateral trading system, its collapse, and the rise of regionalism since World War II, including the factors that influenced the rise of regionalism among developed and developing countries and the role of governments in influencing the nature and forms of regional groupings. It will also examine the more contemporary regional arrangements, such as the European Union and North American Free trade Area, particularly how they handle extra-regional agreements and the expansion of existing arrangements.

Chapter III will focus on the southern African region. Specifically, it will look at regional arrangements in southern Africa which have implications for either or both

countries, including: the SACU, COMESA, SADCC and SADC. This will be followed by an overview of the historical economic relations between Zimbabwe and South Africa, the Preferential Trade Agreement and its weaknesses.

Chapter IV will concentrate on the key comparative macroeconomic indicators of the southern African countries, specially Zimbabwe and South Africa. The issues to be examined are: Gross Domestic product (GDP), productive investment, population and employment levels. The balance of payments (BOP), debt, and the role of public sector enterprises will be analyzed.

Chapter V will look at the trade policies of Zimbabwe and South Africa, the impact of the bilateral (dis)agreement on the patterns of Zimbabwe's trade and tariff structure, particularly Zimbabwe's strategy with respect to multilateral trade, and regional groupings like COMESA, SADC and other bilateral arrangements. This part of the study will analyze the volumes, destination of exports and sources of imports of selected eastern and southern African countries, including Zimbabwe and South Africa. A microeconomic analysis will assess the costs and benefits to Zimbabwe of the existence or absence of a 'formal preferential trade agreement' between Zimbabwe and South Africa. It will also examine the likely gains from a Southern African Free Trade Area, culminating in a common market, and the multiplying free trade areas vice amalgamating all the overlapping regional trade arrangements.

Of relevance, is the weak-strong country bilateral trade relationship regional trade area framework (more than one free trade area), and within a customs union; particularly where the weaker country is also the main competitor for regional trade. Thus, Chapter V will also analyze how the trend towards regionalization of global trade might constrain Zimbabwe's alternatives. The effects on factor movement and direct foreign investment will be considered. Finally, the study will identify those aspects which could contribute to the mutual benefit of both countries.

Finally, Chapter VI will present conclusions and policy recommendations.

## **II. THEORETICAL FOUNDATION OF INTERNATIONAL TRADE AND THE TREND TOWARD REGIONAL ECONOMIC INTEGRATION**

### **A. LITERATURE REVIEW**

#### **1. Traditional and New Trade Theories of International Trade**

Different and sometimes conflicting views have emerged from various economic schools of thought since the 16th century on how individual countries and the world at large can optimize gains from international trade. Mercantilists saw export expansion and import restriction as a means of creating domestic jobs and wealth, and advocated strong government intervention in foreign trade to achieve these goals. Adam Smith saw futility in the mercantilist concept of regulated trade and formulated his theory of absolute advantage. This theory hypothesized that any country with an absolute advantage in producing any commodity would gain by engaging in free trade.<sup>1</sup>

In response to Adam Smith, David Ricardo proposed the concept of comparative advantage. He hypothesized that it was not necessary for a country to have an absolute advantage for free trade to be beneficial. Even if one country were less efficient than another in absolute terms in producing two goods, it could benefit both countries to specialize and trade as long as each country was comparatively more (less) efficient (inefficient) relative to the other.<sup>2</sup>

Trade arises because countries differ in tastes, technology, factor endowments and factor intensity in the production process. This generates different prices or

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<sup>1</sup>Cited by Root, Franklin, R., "Comparative Advantage and Gains from Trade," in International Trade and Investment, 6th ed., pp. 41-66, South Western Publishing Co., Cincinnati, OH, 1990.

<sup>2</sup>Ricardo, David, The Principles of Political Economy and Taxation, 3rd ed., R. D. Irwin, Homewood, IL, 1963. Ricardo used the example of cloth and wine production in England and Portugal to show that although England had absolute advantage in the production of both goods, Portugal was less inefficient in wine production. If England specialized in cloth and Portugal in wine, both countries would increase welfare through free trade. The key assumptions were constant returns and perfect competition.

lower price ratios among rent, interest and wages.<sup>3</sup> The actual gains from trade would depend on the terms of trade for the traded goods, which in turn is determined by the reciprocal demand and changes in the absolute price levels (inflation/deflation) in one or both trading partners.<sup>4</sup>

The purpose of trade was imports. Exports were an indirect way of producing imports because it is more efficient than producing them domestically. The restrictive assumptions of the Ricardian model and its inconsistency with reality led some to argue that starting with different assumptions one would get entirely different outcomes.

The main arguments against the traditional Ricardian model center on the assumptions of perfect competition and constant returns. It is argued that these conditions have been supplanted by imperfect competition and increasing returns. Furthermore, there has been an increase in intra-industry trade and competitive advantage in similar but differentiated products.<sup>5</sup>

Kelvin Lancaster showed that the diversity of consumer preferences and uniqueness of specification were more relevant in explaining intra-industry trade

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<sup>3</sup>Hecksher, Ohlin and Samuelson extended the Ricardian model to show that different factor endowments and intensity in the production process led to different price ratios. See Root, Franklin R., International Trade and Investment, 6th ed., Cincinnati, OH.

<sup>4</sup>Because factors of production are not perfect substitutes, and must be used in different combinations to produce different goods, the dissimilar factor ratios give rise to dissimilar commodity costs that provide the basis for trade. Trade tends to be inter-industry.

<sup>5</sup>Competitive advantage differs from comparative advantage in that it is not endowed, but is created through technological change, economies of scale, learning by doing, etc. This allows a country to create an advantage over its partner.

between similar countries.<sup>6</sup> Product differentiation can arise because of differences in quality of the same product, or different varieties of the same quality. It is the latter which gives rise to intra-industry trade, while the former is associated with inter-industry trade.

Wilfred J. Ethier contributed to this theory by showing that intra-industry trade in manufactures is complimentary to international factor mobility and that contemporary trade is characterized by international returns than national returns to scale.<sup>7</sup> It has also been shown that technological prowess, imperfect competition and increasing returns may, in their own right, create comparative advantage and not the other way around. Technological prowess may be generated by knowledge externalities.<sup>8</sup>

Only one or very few firms survive in certain hi-tech industries on a global level (e.g., aircraft manufactures). Thus, differences between countries is one reason for trade, with others lying in the inherent advantages to specialization and arbitrariness in the initial capitalization and global location factors.

The new trade theory highlights five key issues:<sup>9</sup>

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<sup>6</sup>Lancaster, Kelvin, "Intra-Industry Trade Under Perfect Monopolistic Competition," in Journal of International Economics, Vol. 10, pp. 151-75, 1980. His key assumptions were: 1) differentiated product specification in terms of quality but with same generic characteristics in different proportions; 2) Consumer preferences based on specification, not generic characteristics, so that  $Q_d=f(p, \text{specification})$ ; 3) A change in specification results in loss of economies of scale; 4) Constant returns; 5) Specification is unique to particular firm. He came up with his product differentiation theory, and showed that protection of agriculture by a country with comparative advantage tended to increase trade in manufactures. "Similar" countries refers to similarity in terms of factor endowments, technology, type of manufactured goods, GNP levels, and income distribution.

Greenaway, David, Hine, Robert, and Milner, Chris, "Vertical and Horizontal Intra-Industry Trade: A Cross Industry Analysis for the United Kingdom," in The Economic Journal, 105, pp. 1505-1518, Blackwell Publishers, November 1995. See also Dixit, Avinash K., and Stiglitz, Joseph E., "Monopolistic Competition and Optimum Product Diversity," in American Economic Review, Vol. 67, No. 2, pp. 297-308, June 1977 on consumer utility and product variety.

<sup>7</sup>Ethier, Wilfred J., "National and International Returns to Scale in the Modern Theory of International Trade," in American Economic Review, Vol. 72, No. 1, pp. 389-406, 1982.

<sup>8</sup>Krugman, Paul, "Is Free Trade Passé," in Journal of Economic Perspectives, Vol. 1, No. 2, pp. 131-144, 1987. See also Krugman, Paul, Rethinking International Trade, MIT Press, Cambridge, MA, 1990.

<sup>9</sup>Ibid.

- ◆ International returns to scale depend on interaction between internal and external economies.
- ◆ The factor endowment theory is more robust than the traditional theory in explaining scale economies.
- ◆ Intra-industry, like inter-industry, trade has a factor endowment basis and is complementary to international factor mobility.
- ◆ Internal economies of scale and product differentiation have a significant role in explaining intra-industry trade in manufactures between identical economies.
- ◆ The most competitive market structure, within the manufacturing sector, both in autarky and in trade, will be perfect monopolistic competition.

However, others have argued that increasing returns are not necessary to account for intra-industry trade, suggesting that the new trade model is not inconsistent with, but only a special relation to the traditional Ricardian determinants of trade,<sup>10</sup> or that classical trade theory can explain intra-industry trade.<sup>11</sup>

While some new trade models differ with the traditional approach, they are agreed on the question of free trade and minimum government involvement in influencing trade.<sup>12</sup>

However, the strategic trade policy proponents postulate limited global markets and that any increases in output or wages/profits must of necessity come only by crowding out output or jobs elsewhere. Recent studies show that export subsidies, temporary tariffs and other measures may shift world production in a way favoring

<sup>10</sup>For example, see Davis, Donald R., "Intra-Industry Trade: A Hecksher-Ohlin-Ricardo Approach," in Journal of International Economics, Vol. 39, pp. 201-226, 1995.

<sup>11</sup>Hummers, David, and Levinsohn, James, "Product Differentiation as a Source of Comparative Advantage?" in American Economics Review (AEA Papers and Proceedings), Vol. 83, No. 2, pp. 445-449, May 1993.

<sup>12</sup>For example, see Krugman, Paul, "Is Free Trade Passé?" in Journal of International Economic Perspectives, Vol. 1, No. 2, pp. 131-144, and Krugman, Paul, Rethinking International Trade, MIT Press, Cambridge, MA, 1990.

the protecting country. In a world of increasing returns and imperfect markets, economies of scale allow the pioneer firms to earn super profits, larger than opportunity costs. Assuming super profits are equated to national welfare/interest, any assistance in the form of R&D, export subsidies, or externalities would tilt the scale to favor domestic producers.<sup>13</sup> Brander and Spencer (1988) showed that unionization of labor also results in wages higher than opportunity costs, damaging competitiveness and enhancing the position of rivals.<sup>14</sup>

Under certain circumstances, subsidies (explicit and implicit), promotion of externalities like knowledge, technological innovation and protection, can promote rather than discourage exports and possibly increase national income. This assumes these policies do not have negative domestic effects of negative spill-overs that may provoke retaliation and offset the previous gain.<sup>15</sup> Paul Krugman got similar results in his study, but still opposed government intervention, arguing that any assistance comes at the potential competitors expense, besides distorting internal markets.<sup>16</sup>

Another observation has been that setting up national standards enhances domestic firms competitiveness vice their potential rivals. The setting of minimum quality standards on imports yields negative protection.<sup>17</sup>

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<sup>13</sup>See Corden, Max W., Trade Policy and Economic Welfare, Clarendon, Oxford, 1974. See Brander, James A., and Spencer, Barbara J., "International R&D Rivalry and Industrial Strategy," in Review of Economic Studies, Vol. 50, pp. 707-722.

<sup>14</sup>See Brander, James A., and Spencer, Barbara J., "Unionized Oligopoly and International Trade Policy," in Journal of International Economics, Vol. 24, pp. 217-234, 1988.

<sup>15</sup>Brander, James A., and Spencer, Barbara J., "Export Subsidies and International Market Share Rivalry," in Journal of International Economics, Vol. 18, pp. 83-100. See also Bagwell, Kyle, and Staiger, Robert, "The Sensitivity of Strategic Corrective R&D Policy in Oligopolistic Industries," in Journal of International Economics, Vol. 36, pp. 133-150. See also Hartsmann, Ignatius J., and Markusen, James R., "Up the Average Cost Curve: Inefficient Entry and the New Protectionism," in Journal of International Economics, Vol. 20, pp. 225-247, 1986.

<sup>16</sup>Krugman, Paul, Rethinking International Trade, MIT Press, Cambridge, MA, 1990.

<sup>17</sup>Swann, Peter, Temple, Paul, and Shurmer, Mark, "Standards and Trade Performance: The UK Experience," in The Economic Journal, Vol. 106, pp. 1297-1313, Blackwell Publishers, Oxford, 1996.

The main criticism of the strategic trade policy is that government intervention comes at a high cost, not only to the potential competitors, but also neglected domestic sectors. Knowledge and subsidies, it has been argued, inadvertently benefit foreign producers and consumers.<sup>18</sup> Others have also argued that the Brander and Spencer model is too topical because the particular policy recommendations depend on the details of the model.<sup>19</sup>

However, definitional problems arise when one considers that a subsidy may be direct or indirect. In addition, identifying the impact of indirect subsidies on exports is difficult. Does government spending on education, skills training, infrastructure, public health, reduction in corporate taxes, etc., which obviates such spending by domestic exporters qualify or not? In strict economic terms, why should these measures be less provocative than safety standards, pollution control, minimum prices, funding R&D and export processing zones where equal dollar amounts have been spent?

Nevertheless, most proponents of free trade do not dispute the justification to protect infant industries. Also, the Keynesian case of less than full employment and the Tinbergen active intervention have been acknowledged by economist as valid concepts.<sup>20</sup>

Also, the new trade theory's observation on diversity of specifications, competitive advantages, increasing returns, and imperfect markets have relevance in explaining contemporary trade patterns, at least those aspects not covered by the

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<sup>18</sup>See Eaton, Jonathan and Grossman, Gene M., "Optimal Trade and Industrial Policy Under Oligopoly," in Quarterly Journal of Economics, Vol. 2, pp. 383-406. See also Golt, Sydney, Trade Issues in the Mid-1980s, British-North American Committee.

<sup>19</sup> Krugman, Paul, Rethinking International Trade, MIT Press, Cambridge, MA, 1990.

<sup>20</sup>Keynes, John M., The General Theory of Employment, Interest and Money, Harcourt, Brace and World, Inc., New York, NY, 1965. See also Keynes, J. Maynard, The World Depression: 1929-1939, University of California Press, Berkeley, CA, 1973. For Tinbergen's arguments, see Knoester, A., and Wellink, A. H. E. M., Tinbergen Lectures on Economic Policy, North Holland, Amsterdam. See also Mussa, Michael, "Making the Practical Case for Free Trade," in American Economic Review (AEA Papers and Proceedings), Vol. 83, No. 2, pp. 372-376, May 1993.

traditional theory. The arguments favoring strategic intervention are not inconsistent with reality, at least in the short run, nor have they been convincingly refuted by proponents of free trade.<sup>21</sup> Granted that the new trade theory is inconclusive and has led to rather incomplete variants, what it has uncovered so far is that under certain circumstances, managed trade can be welfare increasing.

## 2. Managed Trade and the Customs Union Theory

The conventional theory of regional trading blocs is based on the work of Jacob Viner.<sup>22</sup> Viner concluded that imposing a common external tariff in a customs union may lead to “trade creation” and “trade diversion.” Trade creation occurs when new opportunities for trade are opened up. As trade creation increases, consumers, firms and governments have a greater chance of achieving the most efficient allocation of resources. Conversely, trade diversion results when trade is restricted. In a system fostering trade diversion, consumers, firms and governments do not always have the opportunity to use the most efficient producer of a specific good, service or resource.

International trade theory states that in a competitive global economy, free trade will maximize global welfare. In this case, it is plausible that any movement toward global free trade will be optimal, while moving toward regional trading arrangements should be a second best solution. An expanded multilateral trading system that results in increased trade creation and less trade diversion would thus be the best policy option as it ensures increases in welfare for all participants.

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<sup>21</sup> See Mittelman, James H., “Globalization: Critical Reflections,” in International Political Economy Yearbook, Vol. 9, Lynne Reiner Publishers, London, 1996. See Paul Krugman, “Free Trade: A Loss of (Theoretical) Nerve? The Narrow and Broad Arguments for Free Trade,” in American Economic Review (AEA Papers and Proceedings), Vol. 83, No. 2, pp. 362-366, May 1993, and Rachel McCulloch, “The Optimality of Free Trade: Science or Religion,” in American Economic Review (AEA Papers and Proceedings), Vol. 83, No. 2, pp. 367-371, May 1993.

<sup>22</sup> Viner, Jacob, The Customs Union Issue, Carnegie Endowment for International Peace, New York, 1950. See also his later work, International Trade and Economic Development, Lectures Delivered at the National University of Brazil, The Free Press, Glencoe.

However, the Vinerian explanation has weaknesses:

- ◆ There are definitional problems regarding tariffs.<sup>23</sup>
- ◆ The model assumes perfect competition, costless transfer of goods and constant returns.
- ◆ It implicitly assumes that tariffs are the only imperfections in the global market, such that their removal/reduction will result in free trade.

The issues of increasing returns and imperfect competition have already been alluded to. Focusing on “border” issues misses the more complex effects of deeper regional arrangements which enforce efficiency (competition policy, common agricultural policy, environmental standards, harmonization of economic policies).<sup>24</sup> Efficiency may increase by liberalizing regional imports, which may reduce export production costs, albeit indirectly, e.g., increase in regional imports also lowers the exchange rate and hence promotes exports. Also, if resources are freed from import industries, they will become available for the export sector. The intra-regional competition may also reduce partners’ costs and attract foreign investment markets due to preferential access to markets in the free trade area. Internal discipline of free-trade areas may also weaken domestic special interest groups.<sup>25</sup>

Small countries, in particular, may get the opportunity to trade in local or regional currency, obviating the need for hard currency.<sup>26</sup> Krugman has observed that

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<sup>23</sup>Ibid. See also Balassa, Bela, The Theory of Economic Integration, R. D. Irwin, Inc., 1961.

<sup>24</sup>Lawrence, Robert Z., Regionalization, Multilateralism and Deeper Integration, the Brookings Institution, Washington, DC, 1996. See also Wonnacott, Ronald J., “Free Trade Arrangements: For the Better or Worse?” in American Economic Review (AEA Papers and Proceedings), Vol. 86, No. 2, pp. 63-66. See as well Marusen, James and Venables, Anthony J., “Increasing Returns and Imperfect Competition: Contradictory Results from Competing Assumptions,” in Journal of International Economics, Vol. 24, pp. 299-316, North Holland, 1988.

<sup>25</sup>Lawrence, Robert Z., “Regionalization, Multilateralism and Deeper Integration,” the Brookings Institution, Washington, D.C., 1996.

<sup>26</sup>Tropp, Richard, “Seizing the Opportunity Preserved by LDC Blocs,” in R. S. Belous and R. S. Hartley (eds), The Growth of Regional Trading Blocs in the Global Economy, National Planning Association, 1990.

if transport costs are significant, then trade diversion may be insignificant between regions.<sup>27</sup>

The effects of quotas and other non-tariff barriers are not explained by the Venerian diversion model. Trade diversion does not even arise when quotas and other non-tariff barriers in the form of health standards, anti-dumping laws, safety standards, are predominant before the regional arrangement is formed. Wonnacott argues that FTAs only reduce welfare as they multiply, not as they expand. Hence, under certain circumstances, there is no negative effect on welfare.<sup>28</sup>

Regional trade arrangements can be an alternative not to free trade, but to existential reality of individual country protectionism and costly import substitution. Since it is not possible to claim an increase or decrease in world welfare in every case, trade creation and trade diversion is rather too situational and the strength of the argument seems to rest on the assumptions made.

## B. TRENDS IN INTERNATIONAL TRADE SINCE WORLD WAR II

### 1. Trends In International Trade Relationships

Since the end of World War II, two different, but not mutually exclusive trends have dominated international economic relations: one advocating free trade at a global level and the other tending toward increasing regionalism through economic integration.

Economic integration can be viewed as a process and a state of affairs. As a process, it seeks to improve the allocation of resources between integrating parties by abolishing discrimination between economic units belonging to different national

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<sup>27</sup>Krugman, Paul, "Is Bilateralism Bad?" in E. Helpman and A. Razin (eds), International Trade and Trade Policy, pp. 9-23, MIT Press, Cambridge, MA, 1991. See also, Jeffrey A. Frankel, Ernesto Stein and Shang-Jin Wei, "Improving the Design of Regional Trade Arrangements," in American Economic Review (AEA Papers and Proceedings), Vol. 86, No. 2, pp. 52-56, 1996. See also Balassa, Bela, The Theory of Economic Integration, R. D. Irwin, Homewood, 1961.

<sup>28</sup>Wonnacott, Ronald J., "Free Trade Agreements: For Better or Worse?" in American Economic Review (AEA Papers and Proceedings), Vol. 86, No. 2, pp. 63-66, 1996. See also Bliss, Christopher, Economic Theory and Policy for Trading Blocks, Manchester University Press, Manchester, 1994. He uses the term "blocks" instead of "blocs."

states; as a state of affairs, it means the absence of discrimination between the national economies and optimal allocation of resources.<sup>29</sup> Integration also differs from cooperation (qualitatively and quantitatively). Cooperation includes actions aimed at lessening discrimination, (e.g., international agreements on trade policies). Economic integration involves some forms of discrimination (e.g., removal of trade barriers to selected countries).

At the global level the main features characterizing relationships have been politics, economics and trade.

- ◆ Political and economic power was concentrated in developed countries which had similar levels of development and relatively few barriers to trade. The Bretton Woods system, formed at the end of WWII, represented the first formal attempt to govern international economic relations. It was envisioned to include the International Monetary Fund (IMF), the World Bank (WB) and a multilateral commercial convention.<sup>30</sup> After the approval of the IMF and WB, the US proposed the Havana Charter which provided for the International Trade Organization (ITO). The ITO was intended to produce a multilateral framework for international economic relations. The General Agreement on Tariffs and Trade (GATT), drawn up in 1947, was designed to fill the gap in international trade until the ITO was approved. However, GATT was made permanent after the failure to ratify the Havana Charter.<sup>31</sup> However the socialist countries were not part of GATT, but had their own exclusive arrangement called the Council for Mutual Economic Assistance, (CMEA).
- ◆ The developing countries supplied raw materials to the developed world while its modern sectors were dominated by foreign investment.
- ◆ The system was made effective through the special role the US played in maintaining a convertible currency and allowing essentially nondiscriminatory access to its domestic market.

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<sup>29</sup> Belassa, Bela, The Theory of Economic Integration, Richard D. Irwin, Homewood, IL, 1961.

<sup>30</sup> Belous, Richard, S., and Hartley, Rebecca, S., "Regional Trading Blocs: An Introduction," in R.S. Belous and R.S. Hartley, (eds), The Growth of Regional Trading Blocs in the Global Economy, National Planning Association, Washington, DC, pp. 1-21, 1990.

<sup>31</sup> Root, Franklin, R., "Multilateral Agreements Under GATT," in International Trade and Investment, 6th ed., pp. 193-212, South-Western Publishing Co., 1990.

From the 1970s, interest in regional economic trading blocs increased. Several factors can be cited for this trend:

- ◆ As the growth of the world economy slowed during the 1970s, the consensus on market openness and trade expansion decreased; at the same time, public interest in protectionism increased, particularly in the developed countries. Since the 1940s, the international institutions had reflected the spirit of equal rights for each nation. But with the realization of growing inequality among equals, the assumptions changed. Most countries questioned continued US dominance, particularly after the collapse of the financial system. Many third world countries became reluctant to continue under the terms of the old arrangements.<sup>32</sup>
- ◆ In contrast to the 1950-60s, the 1970s trade environment was characterized by growing protectionism, anti-dumping complaints, voluntary trade restraints, factitious trade negotiations, miniature trade wars and drastic oil price increases.
- ◆ The oil price increases propelled OPEC countries to a dominant position on the world scene, along with the fast growing economies of Germany and Japan. This shifted the economic power from the previously dominant US and Western Europe. The developed countries response to the oil shock of the 1970s and 1980s was to curtail import demand largely through non-tariff barriers and by substituting imports of primary product inputs.
- ◆ Macroeconomic factors, that could no longer be easily separated from microeconomic factors or industrial structure, contributed to dramatic global imbalances. Of particular concern was the world financial crisis, the twin deficits in the US, and the trade surpluses of Japan and the Asian NICs. The developed countries' response to the 1970s and 1980s oil shocks was to curtail import demand largely through non-tariff barriers and import substitution of primary product imports.
- ◆ The LDC trade was characterized by dependence relationships between the former colonial powers and the newly independent countries. Development depended on favorable conditions for exports,

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<sup>32</sup>Belous, Richard S., and Rebecca S. Hartley, The Growth of Regional Trading Blocs in the Global Economy, National Planning Association, Washington, DC, 1990.

particularly un-fabricated goods, to DCs; meaning that slumps in the latter worsened the terms of trade of LDCs.

- ◆ For a large number of LDCs, commodity prices still determined their capacity to import and service external debt. Accumulating debt as a result of the oil crisis and the falling prices of primary commodity exports, amid increasing manufactured import prices, affected LDCs export volumes and values. The decline in export earnings put pressure on their import demand for oil and import substitution production inputs. This led to stagnation in the LDCs, encouraging them to seek alternative arrangements.<sup>33</sup> This trend continued throughout the 1980s.
- ◆ Less developed countries were also motivated by the desire for economic development. The ‘balanced-growth’ doctrine also hypothesized that economic integration would ensure a sufficiently large market for the parallel development of new industries. Furthermore, because of the increasing power of the European Community and industrialized countries in general, it was hoped that a union would increase the bargaining power and reduce the external vulnerability of member countries.

For sub-Saharan Africa, exports in the 1980s grew by less than 1% a year in the first half of 1990s (export growth per capita in 1991-95 being a mere -1.6%). The countries as a group are expected to achieve an export growth rate of 4.8% over the next decade. In Zimbabwe, inflation peaked at 47% in 1992, while in Zambia it was at 207% during the same year. Zimbabwe’s exports have been falling both in value and in volume, from US\$1,646m in 1988 to US\$1,480m in 1993. The share of manufacturing value added (MVA) in Sub-Saharan Africa fell from 0.4% in 1970 to 0.3% in 1994. After growing very strongly in the 1960s (7.9% a year), Africa’s industrial output has been expanding at a little more than 2% per year, implying falling MVA per capita.<sup>34</sup>

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<sup>33</sup>Adams, Nassau, A., The World Apart: The North-South Divide and the International System, 1993. See also, “Current Trends and Policies in the World Economy,” p. 30-47, World Economic Survey, The United Nations, 1988.

<sup>34</sup>Africa Quarterly Review, The Standard Chartered Bank, Zimbabwe, April, 1995, October 1995, and October 1996.

The globalization of trade has been characterized by the rise in prices of final manufactured products, services and financial markets. ‘Globalization’ refers to a worldwide market place for standardized products.<sup>35</sup> It relies on economies of scale in production, distribution, marketing and management. Globalization has important implications for the volumes of world trade and patterns of trade. It gives countries the opportunity to exploit comparative and competitive advantage on a world scale as it removes all impediments to free trade.

Globalization can be viewed as a move toward a multilateral trading system, which forces countries and firms to devise strategies for leading edge industries relative to global competitors and competing investments. The resulting business climate is defined by factors such as access to world markets and domestic microeconomic and macroeconomic policies conducive to international competition. Globalization also implies removing all impediments to free trade, providing the means to solve disputes, protecting investment from discrimination and establishing rules governing trade in services.

## **2. Role of the Governments in Transforming Regional Arrangements**

The changes in world trade relationships and economic structures have been accompanied by changes in the role of governments. The political debates about the justification of government involvement can be categorized into two schools of thought. On the one hand, the ‘traditional’ trade theories argue that the government should only have a moderate intervention role to regulate macroeconomic policies and facilitate the private market. In contrast, the interventionists maintain that since the market system alone will not achieve balanced development, it is necessary for government to intervene in planning, coordinating and controlling the economic strategy to overcome the ‘imperfections’ of the free market. This argument is

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<sup>35</sup>According to Farrow and York, this term was first used by Theodore Levitt. The interested reader can see Farrow and York, “Regional Trade and Trends: A North American View from the Inside Out,” in R.S. Belous and R.S. Hartley, The Growth of Regional Trading Blocs in the Global Economy, pp. 76-92, National Planning Association, Washington, D.C., 1990.

influenced by the strategic ‘new’ trade theories which have provided intellectual justification for pro-active innovation policies. It is further justified because most successful European and Asian countries seemingly relied on large scale state intervention in leading edge sectors, including subsidized terms of credit, provision of infrastructure, suppression of wages and federal research and development to correct ‘market imperfections.’ The question in East Asia has not been whether states should intervene, but what type of state intervention is appropriate in a specific context.<sup>36</sup>

The infant industry argument has also been used to justify government intervention. Imperfect capital markets and externalities due to large start-up costs created barriers to entry that limited the number of firms that could profitably be active in certain industries. In LDCs, the government played a key role not only in starting new industries, but also planning and controlling economic development, through public sector enterprises.

The interventionist policies, particularly in the ‘inward looking’ import substituting countries, faced problems since the 1970s, largely due to world recession, inflation, unemployment, increasing debt and failing commodity prices. Faced with these difficulties, they were forced to adjust and liberalize trade and ease domestic controls to make exports more attractive, while leaving market forces to regulate the levels of imports (mostly at the insistence of the International Monetary Fund and World Bank).<sup>37</sup>

Apart from political considerations, various factors were responsible for the integration in Europe and other continents.<sup>38</sup>

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<sup>36</sup>Mittelman, James, H., “Globalization: Critical Reflections” in International Political Economy Yearbook, Vol. 9, Lynne Publishers, Boulder, London.

<sup>37</sup>“International Monetary Fund, Issues and Developments in International Trade Policy,” various issues.

<sup>38</sup>For details see Balassa, Bela, The Theory of Economic Integration, 1961. See also Weiner, Herbert, E., “America’s Role in the Founding of The European Community,” in R.S. Belous and R.S. Hartley, The Growth of Regional Trading Blocs in the Global Economy, pp. 57-61, 1990; and Farrow and York, “Regional Trade and Trends: A North American View from the Inside Out,” in R.S. Belous and R.S. Hartley, The Growth of Regional Trading Blocs in the Global Economy, pp. 76-92, National Planning Association, Washington, DC, 1990.

- ◆ The inter-war period witnessed considerable disintegration of Europe and the world economies, partly as a result of increase in trade impediments and payments. Imports of advanced industrial countries in Europe shifted from developed to less developed economies (within Europe) which did not specialize in manufacture goods.
- ◆ Disintegration was further caused by increasing state intervention in economic affairs to counteract cyclical fluctuations, sustain full employment, correct income distribution and influence growth.
- ◆ The establishment of the customs union was expected to help mitigate cyclical fluctuations transmitted through foreign trade-relations. Thus, interest in economic growth further contributed to economic integration.
- ◆ Stalled negotiations, among other things, led to pessimism regarding multilateral arrangements and the rise of regional blocs. The movement towards regional agreements involved 71 countries in 1990, including all the industrialized countries except Japan. The few countries that liberalized trade unilaterally on a most-favored-nation (MFN) basis, mainly in conjunction with a reorientation of domestic policies, did so in the context of regional, bilateral, or sectoral initiatives.
- ◆ GATT was seen as part of the US versus those of the then USSR hegemonic interests, and incapable of dealing with the new world realities. While it is relatively easier to reduce tariffs, it has been more difficult to resolve the issue of non-tariff barriers (NTBs), and to extend GATT to cover other areas like agriculture and services. GATT has also generated adjustment costs, especially for the US which bore the post-WWII reconstruction costs of the European and Asian economies.

The new trends in the role of government, together with the transformation in the global economic structure are being accompanied by the new structures in international trade.

## C. REGIONAL ECONOMIC INTEGRATION

### 1. Regional Trade Arrangements

Historically, as early as 1834, the Zollverein Customs Union was used by Bismarck to bring the small states of Germany under Prussian dominance.<sup>39</sup> Modern regional arrangements started with the European Community in 1957 and spread across the world. In the 1980s, there was growing interest in regional trading arrangements. The trend toward regional trade arrangements is viewed by many as a cause for concern; others view it as a natural consequence of the regional integration that has taken place both formally and informally. These developments raise the question of whether the arrangements are likely to hinder or support open, multilateral trade system. Multilateralism describes an open trading system that includes many nations.

Although GATT did not include all countries of the world (e.g., communist countries who had their own Council for Mutual Economic Assistance (CMEA)), the term “globalism” was often used in reference to the GATT and its guiding philosophies. Thus, GATT is multilateral rather than a global trading system. Furthermore, GATT does not regulate trade between contracting GATT members, as long as the arrangement does not conflict with GATT rules.

In the Uruguay round, negotiated between 1986 and 1993, more than 100 governments agreed to new rules for more open trade in goods and services. The new World Trade Organization (WTO), with enhanced enforcement powers, became legal on 1 January, 1995. But the Third World countries are still unhappy with WTO benefits, which did not seem to address their plight, particularly investment in LDCs, raising the level of both trade and cooperation among LDCs, attracting technology, debt cancellation rates and continued subsidization of agriculture by developed

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<sup>39</sup>Kenen, Peter B., “The Future of the Trading System,” in Refer Kenen (ed) The International Economy, 3rd ed., pp. 256-297, Cambridge University Press, 1994.

countries. The feeling is that LDCs need to widen cooperation among themselves, even in areas like investment and technology transfer. At the same time, however, many regional economic arrangements have been negotiated or revitalized. It is estimated that 90% percent of all contracting parties to the GATT are signatories to regional arrangements, with Japan, Hong Kong and India among the 10 or so exceptions.<sup>40</sup>

At the same time, the increase in regional economic integration has not totally hindered the process toward multilateral liberalization. The arrangements have been highly integrated and have relatively low levels of protection against third countries in most areas of trade. Member countries have gained from both regional integration and exposure to multilateral competition. Although multilateral trade may tend toward the first best choice, many countries have lost faith in GATT/WTO and are turning to regionalism as the realistic second best option.

Compared to the difficulty in reforming the GATT, regional blocs are supported because:

- ◆ Regional trading blocs allow countries and companies to adapt to numerous economic changes at a more manageable level.
- ◆ It is easier to negotiate a bilateral or regional agreement than a multilateral one, thus circumventing the problems associated with non-tariff barriers. Others have argued that the GATT itself was borne out of several regional blocs.

Regional trading blocs and the GATT system differ in certain principles and characteristics. The GATT system rests on two key principles: nondiscrimination and the reliance on tariffs vice quotas for protection.<sup>41</sup> Nondiscrimination means trade

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<sup>40</sup>Lawrence, Robert Z., Regionalism, Multilateralism and Deeper Integration, The Brookings Institution, Washington, DC, 1996. However, Panafrican News Agents Reports of November and December 1996 on the continued dissent by LDCs over the perceived discrimination in the new WTO arrangements.

<sup>41</sup>Belous, Richard S., and Rebecca S. Hartley, The Growth of Regional Trading Blocs in the Global Economy, National Planning Association, Washington, DC, 1990.

should be open to all nations who are willing to follow certain rules. All GATT members are, in theory, bound to grant the same treatment to all other GATT members in applying tariffs and other regulations - the most-favored-nation (MFN) clause of the GATT. No country may give special privileges to another member of GATT. Regional trading blocs are founded on the principle of regional preferences and do discriminate against non-members, even if they are signatories to the GATT.

The second GATT principle is that protection for domestic industries should be provided through tariffs to the maximum extent possible, to make protection transparent. Regional blocs typically use non-tariff barriers, like quotas and other restrictions, especially on textiles and agricultural products.

Proponents of GATT tend to base their views on concepts such as multilateralism, free trade, comparative advantage and economic liberalism, which is consistent with the traditional concept of comparative advantage. Those who back regional blocs favor free trade in certain cases but also favor economic nationalism, regionalism, bilateralism, ideas consistent with the strategic/managed trade theories and neo-mercantilism.

GATT addressed regional blocs by establishing “escape clause” regulations that tolerate regional trading blocs in certain cases. Under Article XXIV of GATT, a regional bloc maybe considered consistent with GATT if the bloc meets a three-part test.<sup>42</sup>

- ◆ The bloc or free trade area must include a substantial share of all the merchandise traded between nations inside the bloc area.
- ◆ The nations that form the bloc must go through a notification process within GATT.
- ◆ The bloc must not be formed to raise new trade barriers to nations outside the bloc.

GATT has considered 69 free trade and preferential trade agreements since 1948.

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<sup>42</sup>Ibid, p. 5.

Free trade allows ‘free riders’ to benefit without taking significant steps to liberalize their own trade. However, GATT does have cases of conditional benefits, which can be enjoyed only if a country contributes toward liberalization. On the other hand, a regional trading arrangement can exclude non-contracting third parties through preferences and discrimination.

Both in theory and in practice, the controversy between multilateralism and regionalism has proven difficult to resolve. Economic rationale suggests that free world trade is optimal. Multilateral free trade allows for a single set of nondiscriminatory rules to govern all trade. But achieving multilateral liberalization in large negotiations that extend benefits unconditionally to all nations has proven difficult.

There are four major questions which need to be asked when considering which of the two alternatives offers an optimal solution:<sup>43</sup>

- ◆ To what extent does the agreement raise barriers to nonmembers?
- ◆ Does the agreement foster stronger economies that are better able to adjust in the future and better able to participate in broader multilateral liberalization?
- ◆ Does the agreement address NTBs issues in a manner consistent with GATT?
- ◆ Do concessions that member countries make to each other preclude liberalization under GATT?

Above all, in the absence of concrete global liberalization, any arrangement that removes trade restrictions may deserve the benefit of the doubt, as a means to reduce external tariffs. For developing countries, it may not be necessary, after all, to negotiate rules too far ahead of immediate problems they seek to solve.

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<sup>43</sup>Morici, Peter, “Regionalism: Motivations and Risks,” in Belous Richard, S., and Rebecca S Hartley, The Growth of Regional Trading Blocs in the Global Economy, pp. 131-36, National Planning Association, Washington, DC, 1990.

## **2. The Levels of Regional Agreements**

Regional economic integration can be achieved in various stages:<sup>44</sup>

- ◆ Preferential Trade Area - members charge each other lower tariffs than those applicable to non-members. Customs duties are levied on imports from other members; there is not yet a free movement of goods within the area.
- ◆ Free Trade Area - eliminates internal tariffs and NTBs but does not harmonize external barriers. Free Trade Areas may be established in two stages: an Industrial Free Trade Area which liberalizes trade in industrial goods; a Full Free Trade Area encompassing all products. The process may also start by reducing quantitative restrictions then by replacing quotas with tariffs.
- ◆ Customs Union - removes internal barriers and establishes common external tariffs and quotas.
- ◆ Common Market - eliminates barriers to the mobility of factors, labor and capital. Countries also establish a common currency and common economic policies.
- ◆ An Economic Union or Confederation - suppresses restrictions on commodity and factor movements and harmonizes economic policies to remove discrimination through macroeconomic policies. A complete economic integration presupposes the unification of monetary, fiscal, social, and counter cyclical economic policies. It requires a supranational authority whose decisions are binding for the members.

Each mechanism involves successively greater integration. Theoretically and historically, agreements at lower levels evolve into higher levels of integration.<sup>45</sup> At each level, there are various types of agreements which are largely influenced by the political and economic circumstances of the integrating partners and the concomitant development strategies. The content and strategies pursued also tend to influence success and failure.

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<sup>44</sup>Balassa, Bela, The Theory of Economic Integration, Richard D. Irwin, Homewood, IL, 1961.

<sup>45</sup>Ibid.

These arrangements reflect obligations and corresponding benefits for the participants, depending on the goals of the members and the desired effect on outsiders. Some of the goals may be economic as well as political. For example, a free trade area limits the power of partners to reinstate internal barriers to trade, but gives the flexibility to adjust external barriers as appropriate, or to negotiate other trading arrangements with outside countries. Nevertheless, the free trade agreement may harmonize customs arrangements and internal institutions to resolve disputes. To achieve harmony, each partner may also need to adjust its fiscal and monetary policies to minimize region-wide distortions. In a customs union, negotiation with outside parties is done jointly, and the harmonizing institutions are more explicit. When the countries reach the common market stage, some national institutions may be subordinated to common market-wide institutions. In fact, countries may have to cede sovereignty to the common market institutions.<sup>46</sup>

### **3. Contemporary Regional Economic Groupings and Bilateral Arrangements**

#### *a. The European Union*

The foundation of European integration is internal trade liberalization. The process of trade liberalization within the European Union has undergone several major phases: the elimination of customs duties and quantitative restrictions from 1958 to 1968; and the successive enlargement of membership from six to twelve by 1973 while eliminating internal barriers. By 1992, the other phase of free movement of goods and factors was completed.

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<sup>46</sup>The participant may be interested in shallow integration (i.e., removing border barriers and providing for national treatment while not necessarily creating genuinely integrated markets). Shallow integration does not often inhibit any of the participants from entering into free trade arrangements with other parties, provided such arrangement does not impinge on the duties and obligations of the first agreement. Alternatively, participants may want to enlarge and deepen the integration. With deeper integration, any negotiation with other parties is conducted by the whole union, not individual states. See Lawrence, Robert Z., "Regionalism, Multilateralism, and Deeper Integration," The Brookings Institution, Washington D.C., 1996.

An earlier precursor to the European Union (EU) was the European Coal and Steel Community (The Treaty of Paris of 1951). Since its early periods, Europe has nearly transformed itself, starting as a customs union with six members, but expanding into a fully fledged single market with fifteen countries sharing common micro- and macro-economic policies. The E.C. and EFTA (Austria, Finland and Sweden) have merged, while several east European countries have signed free trade arrangements with the EU, notably Czech, Hungary and Poland. Preferential trade status is likely to extend to other east European countries, like Russia.<sup>47</sup> The pace of integration has accelerated, as made evident by the proposed European Monetary System and the plans the monetary unification.

The basis for the EU is the 1957 Treaty of Rome that established the E.C. The treaty's goal was to form a common market, by removing tariffs and quantitative restrictions (QR) between member states. The treaty also abolished obstacles to the free movement of services, people and capital.

*b. Achievements*

One way to access the success of regional trading arrangement is to consider the alternatives available, e.g., comparing the external barriers of countries like Sweden and Switzerland to the EU; or to compare Spain and Portugal's agricultural trade barriers before and after they joined the EU. The evidence in both cases suggests that joining the EU has reduced barriers to trade.<sup>48</sup>

Progress in Europe is attributed in part to establishing an international code of conduct governing financial, exchange and trade relationships in the wake of

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<sup>47</sup>Kelly, Margaret and Annie, K McGuirk, in International Monetary Fund: World Economic and Financial Surveys: Issues and Developments in International Trade Policy, p. 5, August 1992. See also, World Economic Survey, various issues.

<sup>48</sup>De Melo, Jaime and Panagariya, Arvind, New Dimensions in Regional Integration, Center for Policy Research, Cambridge University Press, Cambridge, 1993.

WWII. But Europe has contributed much to the design, development and implementation of that code.

- ◆ The first major achievement was eliminating internal tariffs in 1968.
- ◆ The signing of the Maastricht Treaty of 1991, establishing the Single Market Program, and prospects for accommodating former communist countries have expanded the EC and other preferential trade arrangements.
- ◆ The voting system was changed in 1987 to facilitate passage of decisions. Parliament was given more direct decision roles.
- ◆ The EU also created three main institutions - the Parliament, the Commission and the European Court of Justice. The European Court of Justice accelerates decision making, implementation and enforcement.

Several other steps were taken toward the goal of a single market.

These are:

- ◆ The decision to phase-in mutual recognition of academic degrees and professional qualifications.
- ◆ Phasing out restrictions on the movement of capital.
- ◆ Liberalizing insurance arrangements and government procurement.

On the whole, the European integration has led to substantial multilateral liberalization, beyond what would have materialized without the EU.<sup>49</sup>

### *c. Obstacles*

Progress in other areas has been slow due to several interrelated concerns:

- ◆ The indifferent state of the E.C. economy and its structural rigidities.
- ◆ The perception that the E.C. was falling behind due to competition from the US and Japan in hi-tech industries.

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<sup>49</sup>Sapir, Andre, "Regional Integration in Europe," in The Economic Journal, 102, pp. 1491-1506, November 1992.

- ◆ Reluctance by member countries to bequeath sovereignty to EU institutions.
- ◆ Disagreements on future common tariffs and non-tariff adjustments.
- ◆ Difficulty in harmonizing standards for government procurement and investment incentives.
- ◆ Lack of consensus on competition policy (liberal versus strategic approach).<sup>50</sup>

From the foregoing, it is clear that economic integration is a lengthy and difficult process which needs commitment by the partners. As the process progresses, it becomes difficult to proceed without appropriate and correctly empowered institutions.

#### **4. North American Free Trade Area (NAFTA)**

The forerunner to the NAFTA was the US-Canada Free Trade Area (FTA). Before the FTA, the US and Canada had several bilateral agreements, notably, the Reciprocity Treaty of 1874, two trade liberalization agreements in the 1930s, and free trade in agricultural machinery and implements in 1944. The latter agreement is still in place.

The two countries had different but coincidental motivations to enter the FTA.<sup>51</sup> Relative to the US, Canada is a small export-dependent economy. It lacks a market large enough to realize economies of scale and specialization. The bilateral agreement with the US assured Canada of a market for three-quarters of its exports,

<sup>50</sup>Lawrence, Robert Z., Regionalism, Multilateralism and Deeper Integration, The Brookings Institute, Washington, DC, 1996.

<sup>51</sup>Farrow, Maureen A., and Robert C. York, "Regional Trade and Trends: A North American View from Inside Out," in Belous and Hartley, The Growth of Regional Trading Blocks in the Global Economy, pp. 76-92, 1990. When the Canadian economy is booming, they tend to look inward and subsequently engage in nationalistic economic policies including restraint in trade. When times are bad, they look outward to export markets to cure their woes. The US had a similar but reverse cycle: the US looks outward in times of prosperity and inward when the economy slumps. See also Aho, Michael, A "Recipe for RIBS-Resentment, Inefficiency, Bureaucracy, and Stupid Signals," in Belous and Hartley, The Growth of Regional Trading Blocs in the Global Economy, pp. 22-29, 1990.

thus obviating trade diversion on both sides of the border. The US was motivated by delays in concluding the Uruguay Round of GATT negotiations. The FTA was a precautionary move against inconclusive GATT talks. If the GATT failed, the FTA would be a precedent for other bilateral, or trilateral, trading deals. Under the US-Canada FTA, two rounds of accelerated tariff cuts, covering US\$ 8 billion of two way trade, were completed in 1991 without any hitches.<sup>52</sup> The FTA's weakness was failure to address issues like subsidies, intellectual property rights and agricultural liberalization.

In April 1991, Mexico was admitted into what became the North American Free Trade Area (NAFTA). In contrast with the US-Canada Free Trade Agreement, NAFTA's sectoral coverage is more comprehensive and contains more concessions on national sovereignty. NAFTA also has a clause covering most favored nation (MFN) provisions in sectors not included in the agreement. The objectives of NAFTA are:

- ◆ To liberalize trade and bilateral investments, and create a better framework for bilateral investment and trade relations.
- ◆ To solve bilateral trade problems in the automobile sector.
- ◆ To solve problems related to subsidies and tariffs.
- ◆ To create new rules to regulate services trade and liberalize the financial services market.
- ◆ To promote multilateral cooperation within the GATT framework .

One of the most significant provisions is the commitment to eliminate all tariffs and quotas within 15 years... Sixty percent of the tariffs and quotas were eliminated by 1994, with the rest to be phased out in 5-15 years. NAFTA provides that the countries can eliminate tariffs and quotas earlier by mutual consent. However, each NAFTA member retains the right to re-impose restrictions in limited

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<sup>52</sup>Kelly, Margaret, and Annie K. McGuirk in "IMF: World Economic Surveys: Issues and Developments in International Trade Policy," p. 21, August 1992.

circumstances, (e.g., to protect human, animal, or plant health) and special rules for agriculture, the automotive sector, energy, textiles and apparel.

On the services sector, NAFTA disciplines government regulatory measures relating to banking, insurance, securities. In addition, it sets out country-specific liberalization commitments and transition periods for compliance.

In the agricultural sector, NAFTA sets out separate bilateral agreements on cross border trade in agricultural products: Canada versus Mexico, US versus Mexico, and Canada versus US. This arrangement also has a transition mechanism, with trilateral provisions covering domestic support for agricultural subsidies.

Additional features of the agreement are:

- ◆ The eventual elimination of barriers to automotive products.
- ◆ Non-discrimination on intra-NAFTA investment, and investment protection and security in accordance with international law.
- ◆ Protection of investment against unwarranted expropriation, except for public purpose in a non discriminatory manner.
- ◆ Provisions to safeguard intellectual property rights.
- ◆ Establish institutions to implement the Trade Commission and the Secretariat.

Labor market and immigration issues are not covered in the agreement.

The rules of origin in NAFTA are more restrictive, especially on textiles, automobiles and some electronics. NAFTA liberalized foreign investment, services, and intellectual property rights earlier than GATT, but in others areas it has not moved further than GATT.<sup>53</sup>

In most respects, NAFTA members are free to follow domestic policies. Individual member countries are also free to conclude separate trade agreements with

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<sup>53</sup>Lawrence, Robert, Z., Regionalism, Multilateralism and Deeper Integration, The Brookings Institute, Washington, DC, 1996. For example, harmonization of competition policies, elimination of administered protection in anti-dumping, countervailing duty provisions and subsidies.

third countries as circumstances permit.<sup>54</sup> However, the enforcement of each nation's laws is subject to free trade area scrutiny and sanctions in several areas, including the administration of trade rules, labor market policies and environmental policies.

These two examples illustrate that economic integration is a long and difficult process which involves many logical steps. Full integration needs the political and economic commitment of all member states. Appropriate and correctly empowered institutions are crucial in facilitating the process.

The EU's approach of deeper integration leaves less flexibility for members to act unilaterally as they achieve successively higher levels of integration. In contrast, NAFTA, with shallow arrangements, gives the members flexibility to enter into other extra-regional arrangements and to coordinate national macroeconomic policies.

Regional arrangements need concrete but achievable goals. While each of the two arrangements has different objectives and depth (on issues like tariffs, movement of factors, coordination of economic policies), national interests have not been ignored.

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<sup>54</sup>The US has bilateral agreements on various goods with Australia, Japan, Germany, and the E.C. Mexico has complemented its membership in NAFTA by negotiating free-trade agreements with numerous countries in South America, (Chile, Columbia, Venezuela, Costa Rica, Bolivia) and joined both the Asia-Pacific Economic (APEC), in which all NAFTA countries are members, and the Organization for Economic Cooperation and Development (OECD). See "IMF: World Economic and Financial Surveys," various issues.



### **III. REGIONAL TRADE ARRANGEMENTS IN SOUTHERN AFRICA**

#### **A. BACKGROUND**

##### **1. Historical Southern Africa Trade Arrangements**

With independence, African countries saw regional economic integration as a way of reducing dependence links with former colonial countries. Regional solutions were associated with attaining economic independence, development and self-reliant negotiations. Several regional arrangements have been formed, particularly between the 1960s and 1970s, but few have produced tangible results. In any event, this lack of success has not affected renewed interest in regionalization as a way of promoting sustainable development and economic growth.

The first formal regional grouping in Africa dates back to 1910 when the Southern African Customs Union (SACU) was formed.<sup>55</sup> The SACU established common external tariffs and a common monetary area, but it did not seek a common market or confederation status. In the 1960s and 1970s, several regional trading arrangements of different types emerged. Notable was the East African Community (EAC) of 1967, involving Uganda, Tanzania and Kenya. The EAC's long term objective was coordinating economic development and establishing a common market. However, the EAC was disbanded in 1977 before it could achieve this goal.<sup>56</sup> In the 1970s, monetary unions emerged in Central and West Africa, among others, the Communaute Economique de l'Afrique de l'Quest (CEAO); the West African Monetary Union (UMOA), and the Mano River Union (MRU). Monetary unions

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<sup>55</sup>The percussor to SACU was the 1889 economic integration between the Cape of Good Hope and the Orange Free State, and by the mid-1890s all the territories of South Africa came together into a customs union. For details, see Gavin Maasdorp, *Economic Cooperation in Southern Africa: Prospects for Regional Integration*, RISCT, London, 1992.

<sup>56</sup>Earlier in the 1950s some political federations, which were de facto economic communities, were formed e.g., the Federation of Central Africa, comprising the present Zambia, Zimbabwe and Malawi (all were still British colonies). The federation was disbanded in 1963, largely for political reasons and a perceived industrialization bias toward Zimbabwe.

emphasized coordinating monetary policies and using common currencies and exchange rates, with little emphasis on free trade.

The third wave of regional economic groupings, its seeds sown in the 1960s, started in the second half of the 1970s to early 1980s under the auspices of the United Nations Economic Commission for Africa (ECA) and the Organization of African Unity (OAU). The OAU saw regional cooperation as the only viable strategy for the continent's development. This approach advocated four separate regional economic groupings in Africa to provide sufficiently large markets and economies of scale: the Maghreb Union in the North; Economic Community for West African States (ECOWAS); the Customs and Economic Union of Central Africa (UDEAC), and the Preferential Trade Agreement for Eastern and Southern Africa (PTA). While the ECA favored both monetary unions and common markets, the emphasis was on free trade and regional common markets. This offered the most direct route toward full economic collaboration, culminating in an African Economic Community (AEC). In 1980, the Southern African Development Coordinating Conference (SADCC) emerged. SADCC's approach was different from previous regional economic arrangements; it emphasized regional cooperation for economic development rather than trade. Previous studies have adequately dealt with the origins, progress and prospects for regional economic groupings in Sub-Saharan Africa. This study will concentrate on those that have a direct bearing on Zimbabwe and South Africa, like the SACU, PTA and SADCC.<sup>57</sup> Table 3.1 shows the country membership of various groupings.<sup>58</sup>

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<sup>57</sup>See Foroutan, Fazae, "Regional Integration in Sub-Saharan Africa: Past Experience and Future Prospects," in Jaime De Melo and Arvind Panagariya (ed.), New Dimensions in Regional Integration, pp. 234-277, Center for Economic Policy Research, Cambridge, 1993; see also Gavin Maasdorp, Economic Cooperation in Southern Africa: Prospects for Regional Integration, RISCT, London, 1992; and Johnson, Omotunde, E.G., "Economic Integration in Africa: Enhancing Prospects for Success," in The Journal of Modern African Studies, vol 29, No 1, p. 1-26, 1991; Goodison, Paul, and Bernadette Nee, "The SADCC Experience" DPMN Bulletin, 2 (1), April 1994; Mandaza, Ibbo, and Tostensen, Arne, Southern Africa: In Search of a Common Future: from the Conference to a Community, Southern African Development Community, Gaborone, Botswana, 1994; and Hanlon, Joseph, "SADCC: Progress and Prospects," in The Economist Intelligence Unit Report, No. 182, 1984.

<sup>58</sup>In 1990, the Cross Border Initiative (CBI) was set up with the backing of the EU, WB, IMF and African Development Bank (ADB) to promote cross border trade and investment. This regional arrangement is not discussed further in this study. The interested reader can refer to Holden, Merle, "Economic Integration and Trade Liberalization in Southern Africa. Is There a Role for South Africa?" The World Bank, 1996.

**Table 3.1. Country Membership of Regional Groupings**

Country	SACU	CMA	COMESA	SADC
Angola			X	X
Botswana	X			X
Burundi			X	
Comoros			X	
Djibouti			X	
Ethiopia			X	
Eritrea			X	
Kenya			X	
Lesotho	X	X	X	X
Madagascar			X	
Malawi			X	X
Mauritius			X	X
Mozambique			X	X
Namibia	X	X	X	X
Rwanda			X	
Seychelles			X	
Somalia			X	
South Africa	X	X		X
Sudan			X	
Swaziland	X	X	X	X
Tanzania			X	X
Uganda			X	
Zaire			X	
Zambia			X	X
Zimbabwe			X	X

Source: Lists of Regional groupings.

## **B. REGIONAL ECONOMIC AGREEMENTS IN SOUTHERN AFRICA**

### **1. The Customs Union Model**

#### **a. *The Southern African Customs Union (SACU)***

SACU was set up in 1910 as a pragmatic trade and payments agreement not as a growth or development oriented integration program. The present agreement was renegotiated in 1969. SACU embraces South Africa and countries that were once economic regions of South Africa, and latter British protectorates, viz; Botswana, Lesotho, Namibia and Swaziland, which was under South African occupation until 1990 (commonly referred to as the BLNS states). SACU provides for duty free movement of goods (except agricultural products), services and factors among member states, and for a common external tariff against the rest of the world. South Africa unilaterally determines all customs rates, and operates the system to maximize the market for its producers behind substantial protective barriers. SACU operates as a customs pool, with South Africa collecting all import duties for all states.

In terms of the agreement, any BLNS country may protect new industries by levying additional duties on imports for a maximum period of 8 years. Nevertheless, the country has to specify which industries are of importance to the economy as well as the period over which these industries will receive tariff protection or relief. They may also prohibit goods for economic, social and cultural reasons. In addition they may import goods duty free from outside the SACU, but may not re-export to SACU without full duty being paid.

Revenue is shared among the member states according to a formula, in proportion to their share of trade.<sup>59</sup> The revenue distribution scheme was designed

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<sup>59</sup>The formula has three essential parts: 1) The calculation for each state is based on its total imports, both from South Africa and outside; 2) the figure of imports for two years previously is used as basis for initial payments, this means customs revenue on any increase is two years out of date, with no interest! 3) the figure of actual import share is multiplied by a factor of 1.42% to give other members an extra 42% of the total accrued customs revenue. In 1976, the agreement was amended to constrain revenues to 20% of duty, inclusive of the

to ‘compensate’ the BLNS states for leaving trade, monetary and fiscal policies, and industry decisions entirely to South Africa. This arrangement also makes some revenue available to the smaller states for development purposes. Owing to a lack of meaningful industries, the customs revenue constitutes a large proportion of Gross National Product (GNP) of the BLNS countries.<sup>60</sup>

Instead of deepening the integration toward a common market, as is consistent with regional integration theory, SACU has tended toward more shallow arrangements, e.g., less freedom of movement of labor and more individual members participating in competing regional trade arrangements, particularly by the BLNS states.<sup>61</sup> The agreement also does not cover strong mechanisms to counter polarization nor does it aim to promote a more balanced spatial location of industries. However, no significant industrialization has occurred, partly due to stringent export regulations and at times quotas that the BLNS states have to meet to export to South Africa, to minimize damage to its own import substitution program.<sup>62</sup>

Since the mid-1970s, the BLNS states have also expressed disquiet over the revenue sharing scheme and South Africa’s unilateral decisions on the type, level and timing of customs rates to suit her own domestic macroeconomic goals. It

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value of imports and excisable production. See Holden, Merle, Economic Integration and Trade Liberalization in Southern Africa. Is There a Role for South Africa? World Bank, Washington, D.C., 1996.

<sup>60</sup>See Grundy, Kenneth, W., “South Africa in the Political Economy of Southern Africa” in Gwendolen M. Carter and Patrick O’Meara, (eds.), International Politics in Southern Africa, pp. 148-178, Indiana University Press, Bloomington, 1982.

<sup>61</sup>All BLNS joined SADCC, whose objective was to de-link from South Africa, and all, apart from Botswana, became members of a rival regional trade arrangement, the PTA.

<sup>62</sup>For example, Namibia abandoned a car assembly project due to difficulties in securing export markets to South Africa. Several other BLNS industrial ventures faced similar problems after South Africa imposed strict safety, health and local content regulations. See SADC, Regional Relations and Cooperation Post-Apartheid: A Macro Framework Study Report, SADC, Gaborone, Botswana, 1993; see also Hanlon, Joseph, “SADCC: Progress and Prospects,” in The Economist Intelligence Unit Special Report, No. 182, London, 1984.

is argued, this tends to impede economic development and perpetuate dependence in BLNS states.<sup>63</sup>

Finally, the agreement inherently suffers from a conflict of interests. For the other states, customs duty was seen as a source of revenue, whereas to South Africa it is a method of restricting imports, to protect its domestic industries; during the apartheid era, it was a major foreign policy instrument to provide stability in the region.<sup>64</sup>

**b. *The Common Monetary Area as an Arm of SACU***

Related to SACU is the Rand Monetary Area (RMA), first formed in 1974. RMA formalized a defacto monetary union. The RMA was re-negotiated in 1986 to become the Common Monetary Area (CMA). The CMA involves all SACU members except Botswana, which opted to establish its own currency and Central Bank. The agreement allows other SACU members to use the South African currency, or to establish their own currencies while providing for free movement of funds between member states. All CMA members have access to the South African money and capital markets, and foreign exchange from the South African Reserve Bank. The arrangement also provides for compensation for forgone interest from external reserves, consultation on policy decisions, especially on changes in interest rates, exchange control and the right to transfer funds and profits abroad.

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<sup>63</sup>In a Ford Foundation study, Lesotho is said to have discovered that South Africa's ex-factory prices were, on average, 37% higher than on the world market, and with transport costs, still 23% higher, in principle, if Lesotho left SACU and imported goods from the rest of the world, it could charge an average of 23% import duty and get more revenue than at present. Another study showed that Lesotho gained only R1m by exporting to South Africa, while South Africa gained R66m from selling to Lesotho (1 US\$=4.5 South African Rand).

See Libby, Ronald, T., The Politics of Economic Power in Southern Africa, Princeton University Press, Princeton, and Joseph Hanlon, ed., Beggar Your Neighbors: Apartheid Power in Southern Africa, Catholic Institute For International Relations, London, 1987.

<sup>64</sup>Grundy, Kenneth, W., "South Africa in the Political Economy of Southern Africa" in Gwendolen M. Carter and Patrick O'Meara, (eds.), International Politics in Southern Africa, pp. 148-178, Indiana University Press, Bloomington, 1982; see also Joseph Hanlon, ed., Beggar Your Neighbors: Apartheid Power in Southern Africa, Catholic Institute For International Relations, London, 1987.

The 1986 agreement provides for separate bilateral agreements between South Africa and each of the CMA countries to establish their own currency, make direct foreign currency payments using the rand, and issue local currency subject to full backing in rand with the South African Reserve Bank. Namibia's independence in 1990 led to a revision of the agreement in 1992, and the introduction of the Namibian dollar.<sup>65</sup>

Theoretically, each country is responsible for its own monetary policy and financial institutions; in reality South Africa manages the rand, gold and foreign reserves of all the CMA countries.

## 2. Free Trade Area Model: The PTA and COMESA

The PTA was established on 21 December 1981, with its headquarters in Zambia. Initially, the PTA had 18 members; eventually membership increased to some 23 countries and a potential market of around 300 million people.<sup>66</sup>

The PTA Treaty had fourteen protocols which set out, in great detail, the modalities of co-operation. The treaty explicitly recognizes an economic community as its ultimate goal, in conformity with conventional theory of regional economic integration. To move toward this objective, the PTA drew up a common list of commodities, covering 212 categories, on which member states were to eliminate all trade barriers by the year 2000. Customs duties were to be reduced by 25% every two years until eliminated by 1992. To promote trade and overcome currency convertability and shortages, a PTA Clearing House was established in Zimbabwe to

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<sup>65</sup>The Southern African rand is still legal tender in the CMA countries, but is gradually being phased out. Seignorage is calculated by estimating rands in circulation each year based on the amount agreed to in December 1993. See Holden, Merle, "Economic Integration and Trade Liberalization in Southern Africa. Is There a Role for South Africa? in World Bank Discussion Paper No. 342, Washington, D.C., 1996.

<sup>66</sup>The current members of the PTA, now COMESA, are: Angola, Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Seychelles, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zaire, Zambia, and Zimbabwe. The PTA and SADCC have been working toward a merger, to reduce duplication and competition. Of the SADCC countries, only Botswana opted not to join the PTA/COMESA. Also, South Africa was excluded for political reasons.

settle accounts between member states. Balances are offset among different currencies, with outstanding balances settled in hard currency every two months. In 1988, the PTA also established a PTA Trade and Development Bank in Burundi (which was temporarily transferred to Kenya due to civil war). This bank issues PTA travelers checks in the PTA currency, the UAPTA. Other important achievements were setting up a PTA Chamber of Commerce and Industry, the PTA Association of Commercial Banks, and harmonization of road transit charges.<sup>67</sup>

In November 1993, the PTA Treaty established the Common Market for Eastern and Southern Africa (COMESA). The treaty was signed in Kampala, Uganda by sixteen of the member countries, including Zimbabwe, but has yet to be ratified by at least eleven of the required signatory states.<sup>68</sup>

COMESA embodies all the original principal elements of the PTA, like the free trade area, but the target date has been pushed forward to 2005, with a customs union ten years later. In addition, emphasis has been placed on establishing a payments union within the monetary harmonization program and eventually establishing a Monetary Union and free movement of citizens by the year 2020. There has also been an agreement for an 80% immediate tariff reduction by member states.<sup>69</sup>

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<sup>67</sup>For details See also, Gavin Maasdorp, Economic Cooperation in Southern Africa: Prospects for Regional Integration, RISCT, London, 1992; and Foroutan, Fazaeh, "Regional Integration in Sub-Saharan Africa: Past Experience and Future Prospects," in, Jaime De Melo and Arvind Panagariya (eds), New Dimensions in Regional Integration, pp. 234-277, Center for Economic Policy Research, Cambridge, 1993.

<sup>68</sup>Djibouti, Seychelles and Somalia have yet to sign the treaty, while Zimbabwe, Angola, Namibia, Tanzania and Zambia have yet to ratify it.

<sup>69</sup>Nevertheless, the agreement permits member countries to temporarily re-impose tariffs to compensate for 'excessive' revenue losses arising from the tariff reductions. Uganda recently exercised this right by imposing a "temporary" 10% surcharge on imports from its COMESA partners. See Africa Quarterly Review, Standard Chartered Bank, Harare, Zimbabwe, October, 1996.

The main objectives of COMESA are:

- ◆ To attain sustainable growth by promoting a more balanced and harmonious development of its production and marketing structure.
- ◆ To promote joint economic development in all fields and joint adoption of macro-economic policies and programs and to foster relations among its member states.
- ◆ To create an enabling environment for foreign, cross-border and domestic investment including the joint promotion of research and development.
- ◆ To strengthen bargaining positions with the rest of the world.
- ◆ To help establish the African Economic Community.

Notable PTA/COMESA problems are:

- ◆ Delays in concluding the agreement on the common lists due to arguments as to what goods to include or exclude, difficulty in defining the rules of origin, and disagreements over compensatory mechanisms for those countries that would suffer tariff revenue losses.
- ◆ In economic terms, COMESA is the second largest grouping in Africa (after the West African grouping), but because most members are poor and depend on one or two primary export goods, trade was dominated by Kenya and Zimbabwe, who are also highly protective of their own domestic markets.<sup>70</sup> There is also lack of complementarity and uneven distribution of benefits which has stalled any meaningful and effective integration.
- ◆ Instability, cultural and political differences, and strong ties to former colonial markets tend to reduce the potential for full trading.
- ◆ COMESA groups many countries with little mutual trade, and questions have been raised about the size of the grouping and the lack of common economic, historical and political links. While the COMESA Treaty emphasizes trade and monetary affairs, the programs also cover transportation, communications, agriculture and natural resources, duplicating efforts under SADCC.

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<sup>70</sup>Kenya and Zimbabwe accounted for 32 and 27% of intra-PTA exports respectively, while absorbing only 15 and 7% of imports. See Hanlon, Joseph, "SADCC: Progress and Prospects," in The Economist Intelligence Unit Special Report, No. 182, London, 1984; and Gavin Maasdorp, Economic Cooperation in Southern Africa: Prospects for Regional Integration, RISCT, London, 1992.

- ◆ Another important conflict has been between SACU and COMESA. The COMESA treaty demands most favored nation (MFN) treatment among member states, but SACU does not permit members to enter into concessionary agreements with outside countries unless all partners agree. South Africa and Botswana have vetoed Lesotho and Swaziland's concessionary agreements in the past. COMESA had to compromise by allowing Swaziland and Lesotho a 5-year transitional period which was extended for another 5 years. The failure to merge the SADCC and COMESA has been cause for concern.<sup>71</sup>

### **3. Cooperation for Development Model: Southern African Development Coordinating Conference (SADCC)**

SADCC was formed in 1980 by nine southern African countries, Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe, to coordinate cooperation for economic development activities in a limited number of sectors where clear benefits could be gained from regional approaches. Namibia joined the organization upon its independence in 1990. This system of functional regional cooperation was significantly different from the mechanisms for regional cooperation elsewhere in Africa. There was little emphasis on trade and tariff reduction.

Given ideological differences and on-going political and military confrontation in the region at the time, SADCC's primary objective was to reduce dependence of the member countries, especially South Africa, and to promote and

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<sup>71</sup>For example, in January 1997, Mozambique and Lesotho announced their intention to quit COMESA due to its 'monstrous' size and lack of beneficial trade from the arrangement. See Panafriican News Agency, "COMESA to Establish a Common External Tariff," PANA, Dakar, Senegal; and Electronic Mail & Guardian, 20 Jan 1997.

coordinate regional developmental projects.<sup>72</sup> Other important SADCC objectives were:

- ◆ To forge links to create a genuine and equitable regional integration. Although bilateral trade agreements and counter trade between member states were encouraged, economic integration toward free trade areas, customs union, common market and economic community appeared as long term goals. Hence most members of SADCC became members of the Preferential Trade Agreement for Eastern and Southern Africa in 1981, and three of them also remained in SACU and two in the CMA.
- ◆ To mobilize resources to promote national, interstate, and regional policies. The argument for cooperation was based on the rationale of least cost, economies of scale, and easier coordination at a regional level.
- ◆ Concerted action to secure international cooperation within the framework of economic liberation. Almost 90% of SADCC funding and technical assistance was provided by 'international partners in development cooperation,' like the European Community, the Nordic countries, US AID, the UN and the Commonwealth.

Several reasons led to the emphasis on balanced growth rather than free trade.

- ◆ Most SADC countries were pursuing import substitution industrialization, and apart from Botswana, they were also facing acute foreign currency shortages. Issues like tariffs and non-tariff barriers could not address problems facing SADCC, since the obstacles to trade lay in inadequate industrial capacity.

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<sup>72</sup>Although SADCC was formed mainly to exclude South Africa, note must be made that South Africa was, and is still, party to several arrangements to promote cooperation, at multilateral, bilateral, sector specific or project specific level, e.g., the Southern African Regional Tourist Council (SARTOC), Southern African Regional Commission for Conservation and Utilization of the Soil (SARCCUS), Southern African Liaison Meeting on Roads, (SALMOR), Sua Pan Soda-Ash project in Botswana, the Highlands Water Project in Lesotho. Also several agreements on migrant labor and energy were in place with many of the SADCC members. For a detailed discussion on the formation and objectives of SADCC, see Mandaza, Ibo, and Tostensen, Arne, Southern Africa: In Search of a Common Future: From the Conference to a Community, Southern African Development Community, Gaborone, Botswana, 1994; and Hanlon, Joseph, "SADCC: Progress and Prospects," in The Economist Intelligence Unit Special Report, No. 182, London, 1984.

- ◆ All SADCC countries distrusted free trade areas, due to bad experiences, whereby such arrangements ensured that industrial development was concentrated in the most developed country.<sup>73</sup>
- ◆ The free trade concept assumes trade is an end in itself, yet the SADCC concept saw development and production as the goal, with trade as the means to that goal. In addition, a 1975 United Nations Commission for Trade and Development (UNCTAD) had recommended cooperation on joint industries and transport projects among developing countries, instead of integration.<sup>74</sup>
- ◆ The need to de-link from South Africa's multinational corporations and political processes.

The main SADCC institutions were a small Secretariat based in Botswana, plus some technical working groups; the main decision making body was the Annual Consultative Conference, attended by Heads of states. Most of the SADCC projects were coordinated nationally at the sectoral level, with the presumption that each project would benefit most, if not all, SADCC member countries. Each SADCC country was thus responsible for coordinating certain sectors of economic development.<sup>75</sup>

SADCC initially emphasized creating transport and communications infrastructure and the Southern African Transport and Communications Commission (SATCC) was established in Maputo, Mozambique. The reason was that civil wars in that country and Angola had destroyed or disrupted most of the region's shortest and most economic trade routes except through South Africa. Ironically, South Africa

<sup>73</sup>For example, the 1953-63 Central African Federation between Zambia, Malawi, and Zimbabwe benefitted the latter; the Southern African Customs Union benefits South Africa; the East African Community between Tanzania, Kenya and Uganda benefited Kenya and the Portuguese Community involving Portugal, Angola, Mozambique, etc., benefited the colonial power.

<sup>74</sup>For details see, Hanlon, Joseph, "SADCC: Progress and Prospects," The Economist Intelligence Unit Special Report, No. 182, London, 1984.

<sup>75</sup>For example, transportation and port development in Mozambique; food security research in Zimbabwe; energy - Angola; animal disease, coordinated by Botswana; tourism by Lesotho; fisheries by Malawi (marine fisheries were later given to Namibia); mining by Zambia; industry and trade, Tanzania; and human resources - Swaziland.

was largely responsible for perpetuating the economic problems of SADCC member countries by sponsoring the civil wars in these two countries. For example, the closure of trade routes due to war in Angola denied SADCC access to local sources of oil and the accompanying proximity savings.<sup>76</sup> Some studies estimate that it cost SADCC countries almost four times as much to use South Africa's ports.<sup>77</sup> SATCC's major achievement was rehabilitating the rail, road, ports and oil pipelines in Mozambique.

However, by 1987 SADCC focus began to shift toward industry and trade. One reason for this shift was that the International Monetary Fund (IMF) and the World Bank (WB), among other things, opposed the delays in reducing tariffs and government trade controls in heavily indebted developing countries.<sup>78</sup> Thus, most SADCC countries embarked on economic reform programs whose critical facet was trade liberalization. Zimbabwe, for her part, started the economic structural adjustment program in 1991.<sup>79</sup>

Another important reason was that of lack of mutual trade between SADCC countries. Although not a pure trade arrangement, Zimbabwe accounted for 70% of intra-SADCC exports and only 13 % of imports. Paradoxically, South Africa's trade

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<sup>76</sup>Until the end of the 1980s, SADCC states and their infrastructure were targeted for destabilization by South Africa and its allies militarily, politically, economically and psychologically. In 1979 and the early 1980s, South Africa suggested forming a Constellation of Southern African States (Consas). Consas 'veiled' objective was to win back 'SACU's transgressors' (Botswana, Lesotho, Swaziland), and the economically desperate, but politically strategic countries like Zimbabwe and Mozambique. The grouping would also include South Africa's homelands and occupied Namibia. The announced objective was stability through regional economic development and guarantee the continued operation of South African-based MNCs in the region. Others have argued that South Africa's MNCs were used to interfere in the SADCC economies. For details see Libby, Ronald, T., The Politics of Economic Power in Southern Africa, Princeton University Press, Princeton, 1987.

<sup>77</sup>Gavin Maasdorp, Economic Cooperation in Southern Africa: Prospects for Regional Integration, RISCT, London, 1992.

<sup>78</sup>For details, see International Monetary Fund, "Issues and Developments in International Trade Policy," (several issues).

<sup>79</sup>Government of Zimbabwe, "Zimbabwe: A Framework for Economic Reform (1991-95)," Harare, 1991.

with SADCC did not fall. South Africa supplied 90% of imports to Lesotho and Swaziland, 80% to Botswana; 75% to Namibia, 40% to Malawi, and about 20-23% to Zimbabwe, Zambia and Mozambique.<sup>80</sup>

### C. PREVIOUS TRADE AGREEMENTS INVOLVING ZIMBABWE

#### 1. Background to Zimbabwe's Political Economy of Development

Zimbabwe-South Africa relations date back to the last century when a South African-based MNC, the British South Africa Company (BSAC), colonized the present day Zimbabwe (formerly Rhodesia) on behalf of Britain. BSAC administered the country for three decades until 1923. British capital, mostly through South African subsidiaries, dominated all foreign investment. In fact, most of the trade was with Europe until the 1940s, when South Africa became more significant as a source of imports and market for cash crops. Due to the small internal market, the economic growth and success of industrialization was and still is dependent on foreign trade.<sup>81</sup>

Several phases can be discerned in Zimbabwe's trade relationships in the southern African region:<sup>82</sup>

- ◆ Explosive growth was associated with the strong external stimulus of WWI and WWII demand for foodstuffs and raw materials, especially asbestos and chrome.
- ◆ The 1953-63 federation with the now Zambia and Malawi gave Zimbabwe unlimited regional export markets for light manufactures.

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<sup>80</sup>For details, see Hanlon, Joseph, "SADCC: Progress and Prospects," The Economist Intelligence Unit Special Report, No. 182, London, 1984.

<sup>81</sup>See Arrighi, Giovani, The Political Economy of Rhodesia, Mouton, The Hague, 1967; Kay, George, Rhodesia. A Human Geography, University of London Press, 1970; Nelson, Harold D., ed., Zimbabwe: A Country Study, The Secretary of the Army, US Government Printing Office, Washington, D.C., 1983; Grundy, Kenneth, W., "South Africa in the Political Economy of Southern Africa" in Gwendolen M. Carter and Patrick O'Meara, (eds), International Politics in Southern Africa, Indiana University Press, Bloomington, 1982; and Strack, Harry, R., Sanctions: The Case of Rhodesia, Syracuse University Press, 1978.

<sup>82</sup>Strack, Harry, R., Sanctions: The Case of Rhodesia, Syracuse University Press, 1978, and Arrighi, Giovani, The Political Economy of Rhodesia, Mouton, The Hague, 1967.

- ◆ Until 1966, Zambia and Britain accounted for almost 50% of exports, with South Africa and Germany accounting for about 10% each. The import breakdown was roughly 30% from Britain, 23% from South Africa, with the US, Japan, West Germany and Zambia accounting for a total of 20%.
- ◆ Between 1965 and 1980, Zimbabwe's trade relations also changed as a result of economic isolation; Zimbabwe was forced into trade arrangements with previously less significant partners, like South Africa and Portugal, to guarantee export markets.<sup>83</sup>
- ◆ From 1965 to 1980, Zimbabwe's economy developed under highly protective tariffs to minimize the disruptions caused by international sanctions and mitigate foreign exchange shortages. However, from 1980, the protectionist policies were largely for import substitution protection. The emphasis also shifted from traditional primary goods exports to manufactures, increasing export value-added, and non-traditional agricultural exports.
- ◆ In 1991, Zimbabwe embarked on an economic reform program, one facet of which was international trade liberalization to reduce exchange controls and barriers to free trade.

## 2. Historical Zimbabwe-South Africa Trade Agreements

It must be noted that apart from the South Africa-Zimbabwe bilateral trade agreement, there were and still exist several similar arrangements involving all southern African countries.<sup>84</sup>

The preferential bilateral trade agreement with South Africa (on a MFN basis) commenced on 1 January 1964. The agreement had an initial five year term with

<sup>83</sup>Until 1965, Zambia received up to 37.5 % of Rhodesia's exports in some sub-sectors, 66% of re-exports, with total interdependence on power from the jointly owned Kariba Power station from which Zambia sold 70% of its share of electricity to Zimbabwe. Zambia also purchased 100% of all coal requirements. Coal imports from Zimbabwe were cut to 0% by 1971 as were other imports. See Nelson, Harold, D., ed., Zimbabwe: A Country Study, The Secretary of the Army, US Government Printing Office, Washington, D.C., 1983.

<sup>84</sup>For example, the Zimbabwe-Botswana and the Malawi-Botswana bilateral agreements, both dating back to the 1950s. There are also the South Africa-Malawi, Zambia-Botswana (later renounced by Zambia), Mozambique-Tanzania, Mozambique-Malawi, Mozambique-Zimbabwe, Zimbabwe-Tanzania, Tanzania-Zambia, Angola-Mozambique and Zimbabwe-Namibia bilateral agreements. For details, see Hanlon, Joseph, "SADCC: Progress and Prospects," in The Economist Intelligence Unit Special Report, No. 182, London, 1984. Zimbabwe had other bilateral trade agreements with Portugal and its colonies.

automatic renewal unless either party gave 12 months notice of cancellation. It provided for duty free, preferential entry or restrictive quotas for Zimbabwean goods, particularly clothing and textiles, footwear, radios, rod and wire, and selected agricultural products. On the other hand, South African exports include production inputs, some pharmaceuticals, and consumer goods. The arrangement was designed to maximize the diversity of Rhodesian entry while minimizing disruptive effects on South African industry.<sup>85</sup>

South Africa's exports fitted neatly into Zimbabwe's economy (production inputs) with little competition in spite of import substitution, largely because of the extensive South Africa MNC subsidiaries in the latter. Furthermore, the Zimbabwe dollar was only convertible with the South African rand. This trade was almost three times the volume of any other country; the South Africa domination was maintained (albeit reduced) even after removing sanctions in 1980. Others estimate that excluding agricultural products and alloys, South Africa took up to 75% of Zimbabwe's manufactured exports in 1980.<sup>86</sup>

South Africa's economic growth depends on external trade. Compared to the rest of the world, Zimbabwe has always been a minor trading partner for South Africa, but a significant one in the southern African region. In 1984, 75% of South African exports went to developed countries, while only 14% of exports, mostly manufactures, were sold to Africa, excluding SACU.<sup>87</sup> In 1978, Zimbabwe contributed 2-3% of South Africa's imports needs and took just 7-8% of exports. Except for the gold trade, South Africa has had a negative trade balance with all its developed country trading partners, but maintains a concomitant large trade surplus

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<sup>85</sup> Details of the agreement are given in the Southern Rhodesia Government Notice No. 811 of 1964.

<sup>86</sup> Strack, Harry, R., Sanctions: The Case of Rhodesia, Syracuse University Press, 1978; see also Nelson, Harold, D., ed., Zimbabwe: A Country Study, The Secretary of the Army, US Government Printing Office, Washington, D.C., 1983.

<sup>87</sup> In order of importance, the main export markets were the US, Japan, Switzerland, UK, Germany, and Africa, while import sources were Germany, the US, Japan, UK, France, and Italy. See Libby, Ronald, T., The Politics of Economic Power in Southern Africa, Princeton University Press, Princeton, 1987.

with African countries. In particular, trade with Africa helps balance her trade deficit with developed countries. Furthermore, southern Africa consumes the bulk of South Africa's exports, especially capital-intensive manufactures.<sup>88</sup>

Zimbabwe's benefits from the trade arrangement with South Africa are:

- ◆ The agreement helped earn and conserve vital foreign exchange for the highly import-dependent economy; the trade sector constituted about one-third of GDP.
- ◆ The export market was guaranteed and long term planning and scale production was possible.
- ◆ Proximity reduced transportation costs, hence holding down domestic and export prices.

In spite of sanctions, the Zimbabwean economy grew impressively between 1964 and 1974. In 1974, the economy faced acute foreign currency shortages, balance of payments problems and inflation. Some argue that stagnation was inevitable as the benefits of import substituting production of consumer goods were exhausted; others maintain that exogenous factors like the world recession, oil price shocks, civil war, etc., contributed to the decline beginning in 1975.<sup>89</sup>

Despite the advantages, several weaknesses can be identified in the preferential trade agreement with South Africa:

- ◆ The economies are in most respects competitive rather than complementary. Zimbabwe's major exports are agricultural and mining products, with manufacturing geared toward the domestic and less developed economies of southern Africa. Because South Africa is a major producer and exporter in the same sectors, Zimbabwe could only get access in those areas in which the domestic market was available. South Africa's failure to penetrate Western manufactured goods

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<sup>88</sup>Ibid.

<sup>89</sup>See Nelson, Harold, D., ed., Zimbabwe: A Country Study, The Secretary of the Army, US Government Printing Office, Washington, D.C., 1983. See also Joseph Hanlon and Colin Stoneman, "Zimbabwe: The Private Sector and South Africa" in Joseph Hanlon, ed., Beggar Your Neighbors: Apartheid Power in Southern Africa, pp. 199-218, Catholic Institute For International Relations, London, 1987, and Strack, Harry, R., Sanctions: The Case of Rhodesia, Syracuse University Press, 1978.

markets meant that the Zimbabwean goods were in direct competition with South African producers in Africa.

- ◆ The agreement was not based on principle of reciprocity. Zimbabwe's economy was inherently desperate and vulnerable, owing to international sanctions, and too dependent on exports (and implicitly imports) to survive.<sup>90</sup> South Africa became a captive supplier and source of imports, and unilaterally amended the agreement on several occasions. They imposed quotas in certain areas while reducing others at will.
- ◆ As competition from Zimbabwe stiffened, some South African manufacturers pressured their government to restrict the preferential access of Zimbabwean goods. For example, in 1976, Zimbabwean textiles were forced to meet limited quota ceilings as an alternative to an increased duty which might have priced them out of the South African market.<sup>91</sup>
- ◆ The agreement did not have a devaluation clause and most quotas were specified in value terms, using the South African currency.<sup>92</sup> Where value quotas are used, any inflation, devaluation or depreciation in the specified currency reduces tradeable volumes. Because exports become more expensive, this reduces the foreign exchange potential of exports. Zimbabwe's desperate economic position made tradeables price inelastic. To South Africa, it is evident that imports from Zimbabwe were less inelastic (clothing, textiles, agricultural products, radios, etc.) and easily replaceable with local production and/or competing imports.
- ◆ On the import side, it is alleged that some South African exporters added currency devaluation effects to the prices.<sup>93</sup> Since Zimbabwe's

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<sup>90</sup>The Rhodesian Prime Minister, Ian Smith, is quoted as saying on April 1975, "...the imposition of sanctions created many trading problems for us... we are compelled to export at a discount and import at a premium....we lose on both transactions...This has the effect of reducing profit margins internally, and at the national level it has an adverse effect on our BOP and foreign reserves." Another Govt. Minister, J. J. Wrathall had this to say, "...exports are our life blood. Our success or failure as a nation depends on our ability to make good, by whatever means possible, the loss of the export markets which have been closed by sanctions." Strack, Harry, R., Sanctions: The Case of Rhodesia, Syracuse University Press, 1978.

<sup>91</sup>Ibid.

<sup>92</sup>See Southern Rhodesia Government Notice No. 811 of 1964.

<sup>93</sup>See Strack, Harry, R., Sanctions: The Case of Rhodesia, Syracuse University Press, 1978.

imports are predominantly production inputs and capital goods, increases in import prices directly affect production costs, with obvious consequences on the export prices. Any increase in export production costs leads to increased export prices, making the country less competitive in all export markets in which South Africa and Zimbabwe compete.

- ◆ The agreement is out-of-date, and has not been systematically revised to include new products and increasing production capacities.
- ◆ The existence of SACU, and South Africa's bilateral agreements with most of the southern African countries, curtailed Zimbabwe's competitive potential in the region.
- ◆ With poor political relations between Zimbabwe and South Africa between 1980 and 1994, most of South Africa's decisions on the agreement were based more on political intolerance than economics. For example, in 1980, the South African Credit Guarantee Insurance Cooperation limited coverage to just 25% on all new exports, and in March 1981, South Africa gave 12 months notice to abrogate the bilateral trade agreement, with at least 7000 jobs lost in the textile sector. Under international political pressure, South Africa grudgingly extended the agreement less than a fortnight before the agreement was due to expire in March 1982. However, most South Africa buyers had already found alternative sources for many of the goods; worse still, uncertainty remained as to the next action.<sup>94</sup>

Nevertheless, unilateral revision of the agreement continued. The clothing and textile tariff was increased from 30% to 90% between 1992 and 1996, amid reluctance by South Africa to renegotiate. It is estimated that the Zimbabwean clothing and textile sectors lost 17,000 jobs (11,000 in textiles). Much of the blame has been laid at the door of highly protectionist policies in South Africa, traditionally the industry's chief export market. The situation was worsened when the Zimbabwean government removed subsidies on locally produced cotton lint. Substantive negotiations only started in June 1996, again after pressure from the US

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<sup>94</sup>Hanlon, Joseph, Beggar Your Neighbors: Apartheid Power in Southern Africa, Catholic Institute For International Relations, London, 1987.

and the EU.<sup>95</sup> The ongoing negotiations have produced some progress on reducing tariffs to their 1992 levels on clothing and textiles, cotton lint and footwear, but very little progress in agriculture and light manufactures.<sup>96</sup>

#### **D. TRANSFORMATION OF SADCC INTO THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY (SADC)**

##### **1. Evolution of SADC**

Among other things, SADCC was transformed into SADC because of the need to benefit participation in all sectors, especially the region's productive investment and trade. The Declaration and SADC Treaty were signed in Windhoek, Namibia in August 1992. The treaty emphasizes growth through free trade. Instead of cooperation, it emphasizes financial mechanisms to support intra-SADC trade, cross border investment, free movement of factors of production and strengthening of institutions. The sub-objectives include: self-reliance and interdependence, strong political relations, peace and security goals.<sup>97</sup>

The SADC Trade Protocol moves toward a free trade area over eight years to give members time to re-adjust and minimize shocks and adverse effects on their economies. The movement toward free trade will be through phased tariff reductions, but details are still being finalized. As in the old SADCC, the protocol

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<sup>95</sup>See Africa Quarterly Review, Standard Chartered Bank, Harare, Zimbabwe, October, 1995.

<sup>96</sup>PANA, "South African Tariff Cut Negotiations Continue," Panfrican News Agency, Dakar, Senegal, 3 December 1996.

<sup>97</sup>For details see Mandaza, Ibbo, and Tostensen, Arne, Southern Africa: In Search of a Common Future; from the Conference to a Community, Southern African Development Community, Gaborone, Botswana, 1994; and SADC, SADC: Resources, Institutions and Capacity for Integration: The Proceedings of the Consultative Conference, held in Lilongwe, Republic of Malawi, SADC, Gaborone, Botswana, 1-4 February, 1995. See also Paul Goodison and Bernadette Nee, "The SADCC Experience," DPMN Bulletin, 2(1), April 1994.

encourages a system of bilateral trade measures, bilateral trade arrangements and an exchange of reciprocal preferences.<sup>98</sup>

In this light, the SADC approach departs from the conventional economic theory of regional economic integration, which does not encourage concurrent bilateral trade agreements by participating countries.<sup>99</sup>

The following constraints were to be addressed:<sup>100</sup>

- ◆ Bureaucratic, regulatory and administrative non-tariff barriers to the movement of goods and services, and factors of production.
- ◆ The non-convertability of currencies and other payments related problems.
- ◆ Physical and economic infrastructure which remains inadequate in a number of areas.

Member states were to enter into specific agreements and protocols in these areas, providing for the scope and activities of integration, and specifying the rights, duties and obligations of the parties involved.

## **2. Important Developments Since the Signing of the Protocol**

In spite of membership in SADCC and COMESA, most of Zimbabwe's trade is still with South Africa. South Africa has maintained a positive trade balance with Zimbabwe since the late 1970s. The trade deficit increased nine-fold between 1990 and 1995, from Z\$580m to Z\$6.8 billion. During the same period, Zimbabwe's exports to South Africa as a proportion of imports from the same country declined from 36% to 23%. This economic relationship with South Africa has been a source of irritation between southern Africa's most industrialized countries. Of relevance

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<sup>98</sup>South Africa preferred a longer a period to allow other regional countries to adjust, but other countries insisted on 8 years; SADC: Resources and Institutions and Capacity for Integration: The Proceedings of the Consultative Conference, held in Lilongwe, Republic of Malawi, SADC, Gaborone, Botswana, 1-4 February 1995.

<sup>99</sup>Balassa, Bela, The Theory of Economic Integration, Richard D. Irwin, Homewood, IL, 1961.

<sup>100</sup>Mandaza, Ibbo, and Tostensen, Arne, Southern Africa: In Search of a Common Future: from the Conference to a Community, Southern African Development Community, Gaborone, Botswana, 1994.

was that South Africa, with a population of less than half of SADC, had a GDP nearly three times that of all SADC countries combined.<sup>101</sup>

South Africa's public enterprises significantly increased their regional role in areas of energy; Eskom negotiated deals in Mozambique, Zambia, and Zimbabwe on hydroelectric interconnections, rehabilitation, and new power sites. SADC members recognized South Africa's importance in any future regional arrangement. Thus, democratic South Africa was duly granted SADC membership in 1994, followed by Mauritius in 1995.

The resumption of negotiations to resolve long-running trade disputes between member countries (e.g., Zimbabwe with South Africa and Botswana with South Africa) has strengthened the political will to resolve contentious issues through negotiation.

The Consultative Conference held in Malawi in 1995 endorsed SADC protocols outlining short-term, medium-term, and long term goals. The protocols cover finance and investment, coordinating fiscal and monetary policies to harmonize interest rates, reducing inflation and government budget deficits, establishing a development bank, energy, transport and communications, mechanisms for compensation, property rights, trade, public sector enterprises, free movement of labor and capital, and strengthening institutions. Active participation by the private sector and labor organizations, both in SADC and bilateral discussions, enhances the chances of the agreements being ratified.

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<sup>101</sup>Standard Chartered Bank, Harare, Zimbabwe, October, 1995. 1 US\$= approx 10.8 Zimbabwe \$. See also Gavin Maasdorp, Economic Cooperation in Southern Africa: Prospects for Regional Integration, RISCT, London, 1992; Hanlon, Joseph, "SADCC: Progress and Prospects," in The Economist Intelligence Unit Special Report, No. 182, London, 1984; and Grundy, Kenneth, W., "South Africa in the Political Economy of Southern Africa" in Carter, Gwendolen, M., and O'Meara, Patrick, ed., International Politics in Southern Africa, pp. 148-178, Library of Congress, Indiana University Press, Bloomington, 1982.

Voluntary tariff reduction by Zimbabwe early in 1997 enhances competitiveness. For example, tariffs on capital imports were cut from 0-25% to 0%, and on raw materials from 40% to 5%.<sup>102</sup>

The Consultative Conference resolved that new protocols should not reverse the gains by countries which are already at a higher stage of integration (e.g., SACU), but that the other countries will have to eventually ‘catch-up’ with SACU.<sup>103</sup> This set the stage for the eventual signing of three of the fourteen Protocols in Lesotho in 1997.<sup>104</sup>

The size of South Africa’s market and relative strength of its economy has caused most southern African countries to rush to have favorable hub-and-spoke trade arrangements with South Africa as quickly as possible. The hope is that South Africa will provide a stronger basis for regional economic cooperation and integration in southern Africa. This also duplicates the roles of COMESA and SACU.<sup>105</sup> South Africa has limited resources and her own internal macroeconomic imbalances to deal with, hence many countries believe that the best way to guaranteed access to these is to establish a close relationship as soon as possible. Because current bilateral negotiations are not taking place within a broader framework, the danger is that some bilateral agreement could extend to long term relationships. This could shape the future of the region, likely with adverse impacts on SADC.

On the other hand, because most African countries are reluctant to surrender sovereignty where potential benefits are low, SADC leaders seem to have realized

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<sup>102</sup>“Zimbabwe Announces New Tariffs,” Pan African News Agency, Dakar, Senegal, 14 Feb 1997.

<sup>103</sup>SADC: Resources and Institutions and Capacity for Integration; The Proceedings of the Consultative Conference, held in Lilongwe, Republic of Malawi, SADC, Gaborone, Botswana, 1-4 February 1995.

<sup>104</sup>At the time of writing, it was learned that the initial protocols involving, energy, trade and transport and communications had been signed. However, details are not yet available. See “SADC Leads African Reform,” Pan African News Agency, Dakar, Senegal, 10 February 1997.

<sup>105</sup>See SADC, Regional Relations and Cooperation Post-Apartheid: A Macro Framework Study Report, SADC, Gaborone, Botswana, 1993; and Mandaza, Ibbo, and Tostensen, Arne, Southern Africa: In Search of a Common Future: from the Conference to a Community, Southern African Development Community, Gaborone, Botswana, 1994.

that it is better to concentrate efforts on modest activities in which benefits to all participants are clear and appropriable. This approach is similar to the one adopted by the European Community when it began its series of cooperation agreements on iron and steel; and compares with NAFTA, where partners have complemented the free trade agreement with a series of bilateral and multilateral trade agreements, even with partners.

The announcement that South Africa is soon to start free trade negotiations with the European Union has caused anxiety in all southern African countries. This arrangement excludes all SADC, let alone SACU members. Estimates indicate that SACU members would lose about R1 billion in revenue if South Africa concludes a free trade agreement with the EU.<sup>106</sup>

It is not clear how issues like poor marketing, MNC trade with their subsidiaries, inherited product preferences, bureaucracy, price and tariff policies or lack of complementarity in products limit SADCC/COMESA trade. In this context, the only effect of integration would be indirect and related to the new level of protection by the group toward the rest of the world. In economic theory, in a two-good model, trade will have trade creation and trade diversion effects when partners each have a comparative advantage in production and export of a different good and both goods are consumed by both countries. Factor endowments drive them to be natural trading partners. Where states are similar, product differentiation and/or complementary industrial sectors will result in intra-industry trade in manufactures, owing to created competitive advantages. On the other hand, most southern African countries produce similar primary products. This makes the arrangement inconsistent with traditional and new international trade theories.

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<sup>106</sup> However, the EU disputed the accuracy of the Harare-based consultancy report. It has also been suggested that the EU plans to compensate the losing SACU countries, although no mechanisms outside the LOME Convention exist to compensate losing countries. See Electronic Mail & Guardian, "Free Trade With EU Will Hurt SA's Neighbors," Mail and Guardian News, South Africa, 30 Oct 1996 and 05 November 1996; and Africa Quarterly Review, Standard Chartered Bank, Harare, Zimbabwe, October, 1996. 4.5 Rand = approx 1 US\$.

## IV. MACROECONOMIC INDICATORS

This chapter analyzes some of the major macroeconomic indicators for Zimbabwe and South Africa within the SACU, SADC and COMESA contexts. Among the countries of southern Africa, there are differences in the size and growth of GDP, structure and growth of production sectors, levels of economic development, distribution of employment and output across sectors, government participation in the economy, trade patterns and levels and structure of external debt.

Since the early 1960s, the countries of eastern and southern Africa have been afflicted by national liberation and civil wars. This has affected all countries in this region (militarily, economically, socially and politically) except perhaps Mauritius. Zimbabwe and South Africa were subjected to international trade sanctions between 1965-80 and 1986-93, respectively. As such, the international trade statistics on items like oil and arms are circumspect or understated.<sup>107</sup>

Data availability and reliability in reporting has been affected by the effects of civil wars, illegal border movement between countries and the relatively large informal sectors in most countries, resulting in unrecorded data. Therefore, the statistics that follow may only present a partial picture of intra-eastern and southern Africa trade.

### **A. CHARACTERISTICS OF EASTERN AND SOUTHERN AFRICAN COUNTRIES AND REGIONAL GROUPINGS**

#### **1. Demographic and Basic Macroeconomic Indicators**

South Africa dwarfs all the southern African countries in terms of population (market size of the economy). South Africa contributes 78.6 percent of total SADC output, two and one half times that of all COMESA countries and 93 percent of SACU members. In 1994, South Africa's per capita GNP was three and one half times the SADC average, and almost five times that of the COMESA. That same

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<sup>107</sup>Several eastern and southern African countries are still engulfed by civil wars, e.g., Sudan, Somalia, Zaire, Burundi, Uganda; while recently wars ended in Mozambique and Rwanda.

year, total GNP was over 22 times that of Zimbabwe, with a per capita GNP was six times as great. Only Mauritius exceeds South Africa's per capita GNP. Compared to SADC and COMESA, Zimbabwe contributed just 3.4 percent and 11 percent, respectively. The per capita GNP stood at four-fifths of the SADC average and 106 percent of that of COMESA.

The data on the remaining southern African countries is equally disparate compared to South Africa. See Table 4.1.

**Table 4.1. SACU, SADC and Selected COMESA Basic Macroeconomic Indicators**

Country	Area (MKm <sup>2</sup> )	Population (millions)	Total GNP (US\$) <sup>a</sup>	GNP per capita (US\$) <sup>a</sup>
			1994	1994
<b>SACU:</b>				
Botswana	0.58	1.4	3920	2800
Lesotho	0.03	1.9	1368	720
Namibia	0.82	1.5	2955	1970
Swaziland	0.02	0.8	840	1050
<b>South Africa</b>	<b>1.22</b>	<b>40.5</b>	<b>123120</b>	<b>3040</b>
<b>Total SACU:</b>	<b>2.67</b>	<b>46.1</b>	<b>132203</b>	<b>2337.5</b>
<b>Non-SACU SADC:</b>				
Angola	1.25	10.0	6500	650
Malawi	0.12	9.5	1615	170
Mauritius	0.002	1.1	346.5	3150
Mozambique	0.8	15.5	1395	90
Tanzania	0.95	28.8	2880	100
Zambia	0.75	9.2	3220	350
<b>Zimbabwe</b>	<b>0.39</b>	<b>10.8</b>	<b>5400</b>	<b>500</b>
<b>Total SADC:</b>	<b>6.932</b>	<b>131</b>	<b>156678</b>	<b>918.4</b>
<b>Non-SADC COMESA:<sup>b</sup></b>				
Burundi	0.028	6.2	992	160
Ethiopia	1.097	54.9	5490	100
Kenya	0.6	26.0	6500	250
Madagascar	0.587	13.1	2620	200
Uganda	0.2	18.6	3534	190
<b>Total COMESA</b>	<b>1.64</b>	<b>207.9</b>	<b>28774</b>	<b>615.1</b>

**Table 4.1. (Continued)**

Country	Area (MKm <sup>2</sup> )	Population (millions)	Total GNP
			1994
South Africa as % of SACU	45.7	87.9	93.1
South Africa as % of SADC	17.6	30.9	78.6
South Africa as % of COMESA	15.9	19.5	252.5
Zimbabwe as % of South Africa	32	26.7	4.4
Zimbabwe as % of SADC	5.6	8.2	3.4
Zimbabwe as % of COMESA	5.1	5.2	11.1

Source: World Development Report, 1992, 1996.

\*Data on other COMESA countries is not available or incomplete.

Eastern and southern Africa includes four of the world's poorest countries (Mozambique, Tanzania, Ethiopia and Malawi) and three of sub-Saharan Africa's richest (Mauritius, South Africa and Botswana).

In general, SACU members exhibit comparatively higher per capita GNP levels and growth rates than SADC and COMESA members, with the exception being Mauritius. Thus, South Africa can be an engine for growth or a source of stagnation for the entire region.

## **2. Economic Growth of Regional Economies by Productive Sectors**

The statistics on the performance of individual economies is summarized in Table 4.2. The smaller SACU members and Mauritius had the most consistent growth during the period. Mauritius' decline in agriculture seems to have been compensated by high growth rates in services and industry. Outside the SADC, Kenya and Uganda performed well.

**Table 4.2. Economic Growth by Productive Sector**

	Average Annual Real GDP Growth Rate (%)			Growth of Production by Sector (%)					
				Agriculture		Industry		Services	
	1965-1980	1980-1990	1990-1994	1980-1990	1990-1994	1980-1990	1990-1994	1980-1990	1990-1994
Botswana	13.9	10.3	4.4	2.2	0.6	11.4	1.7	11.0	7.9
Lesotho	6.8	4.3	6.1	2.6	-2.3	7.2	11.4	3.6	4.7
Namibia	N/A	1.1	4.1	1.8	6.8	-1.1	2.9	2.2	4.1
Swaziland	N/A	9.0	4.1	N/A	N/A	N/A	N/A	N/A	N/A
South Africa	3.7	1.3	0.1	3.0	-2.3	1.1	-1.2	2.9	0.6
Angola	N/A	N/A	8.6	-0.5	N/A	12.6	N/A	N/A	N/A
Malawi	5.5	2.7	-0.7	-0.6	6.4	2.9	-0.4	3.0	-1.0
Mauritius	5.2	6.5	5.3	2.6	-2.1	9.2	6.0	4.2	10.4
Mozambique	N/A	-0.2	7.3	-0.6	6.4	2.9	-0.4	3.0	-1.0
Tanzania	3.9	2.8	3.1	4.9	5.8	3.4	9.7	2.8	-12.7
Zambia <sup>a</sup>	2.0	0.8	0.1	3.6	2.1	1.0	-1.3	0.1	0.4
Zimbabwe	5.0	3.2	1.1	2.4	1.6	3.6	-3.6	3.9	1.3
Burundi	7.1	3.3	-1.4	3.1	-3.1	4.5	-3.4	1.5	N/A
Ethiopia	2.7	1.8	N/A	1.1	-	0.1	-	4.4	-
Kenya	6.8	4.2	0.9	3.3	-1.5	3.9	0.9	4.8	2.0
Madagascar	1.6	1.1	-0.2	2.3	3.3	6.0	9.3	3.5	7.7
Uganda	0.6	3.1	5.6	2.6	-2.1	9.2	6.0	4.2	10.4

Source: World Development Report, 1992; 1996; IBC USA Licensing Inc., 1996.

<sup>a</sup>In 1996, Zambia estimates for GDP growth was 4.0%, Zimbabwe's was 7.0%, while South Africa and Angola real GDP growth rates were estimated at 3.0% and 2.5% respectively.

\*Manufacturing figures are included in industry data, hence should not be added to arrive at 100%.

Zimbabwe's economy achieved high growth rates up to 1990, but declined in the 1990s. The decline resulted largely from poor performance in the agricultural sector. Agriculture drives the economy. During the same period, South Africa experienced a more or less similar growth pattern. Although correlation does not prove causality, slow or negative growth in South Africa seems to have been repeated in Zimbabwe, but not in smaller SACU members which trade freely with South Africa.

The remaining SADC countries, except Angola and Mozambique, experienced declines in secondary and tertiary sectors, but positive growth in the primary sectors. Angola and Mozambique were largely engulfed by civil war.

### 3. Productive Structure and Distribution of Gross Domestic Product by Sector

The structures of regional economies can be described by the relative shares of GDP attributed to agriculture, industry, manufacturing and services (primary, secondary and tertiary industries, respectively). This data is shown in Table 4.3. Apart from Namibia, Tanzania and Madagascar, the trend has been a decline in the importance of agriculture relative to industry and services. Within industry, manufacturing has successively contributed higher proportions.

**Table 4.3. Distribution of GDP by Sector (Percentage of Total\*)**

	Agriculture		Industry		Manufacturing*		Services	
	1980	1994	1980	1994	1980	1994	1980	1994
Botswana	13	5	44	49	4	4	43	46
Lesotho	12	14	29	46	7	17	47	40
Namibia	12	14	53	29	5	9	35	36
South Africa	7	5	56	31	23	23	43	63
Angola (1990)	-	13	-	44	-	4	-	43
Malawi	37	31	19	21	12	14	44	47
Mauritius	12	9	26	33	15	22	62	58
Mozambique	37	33	31	12	-	-	32	55
Tanzania	46	57	18	17	11	8	37	26
Zambia	14	31	41	35	18	23	44	34
Zimbabwe	14	59	34	36	25	30	53	48
Ethiopia	56	57	12	10	6	3	31	32
Kenya	23	29	21	17	13	11	47	54
Madagascar	30	35	16	13	-	-	54	52
Uganda	72	49	4	14	4	7	23	37

Source: World Development Report, 1992; 1996.

\*To arrive at 100%, Manufacturing has been excluded as it is a part of industry.

South Africa's 50 percent decline in agriculture has been offset by a shift toward the service sector. This reflects the higher level of economic development in that country. Nevertheless, industry and manufacturing have remained relatively high

compared to the primary sector. Countries with relatively large manufacturing sectors are South Africa, Zimbabwe, Mauritius, Zambia, Kenya and Lesotho.

In Zimbabwe, the importance of agriculture, though still significant compared to South Africa and Mauritius, declined by 16 percent over the period; the service sector fluctuated around 48 percent. South Africa, Mauritius, Kenya, Mozambique and Madagascar have higher service sector proportions than Zimbabwe, reflecting strong tourism in the latter three.

#### **4. Employment Levels and Distribution by Sector**

Employment statistics show that agriculture still absorbs a high proportion of the labor force in Zimbabwe (68 percent), with industry's contribution declining from 12 percent to eight percent between 1980 and 1990. It can be seen in Table 4.4 that both the agricultural and industrial sectors lost labor, in spite of the accompanying growth in the labor force. This pattern is repeated in most SADC countries, but reversed in Mauritius.

**Table 4.4. Urban Economically Active Population (EAP) and Contribution by Primary and Secondary Sectors to Employment (SADC Countries)**

	Potential Labor Force (Age 15-64) (millions)		EAP as % of Total Labor Force	Total Formal Wage Employment	Formal Wage Employment as a % of EAP		Agriculture as a % of Formal Wage Employment	Industry as a % of Formal Wage Employment	
	1980	1994			1990	1990			
			1990			1990	1980	1990	
Botswana	N/A	N/A	0.415	207500	50.0	63	46	10	20
Lesotho	1	1	0.59	40000	7.0	41	40	34	28
Namibia	1	1	0.55	236500	43	56	49	15	15
Swaziland *	N/A	N/A	N/A	113000	N/A	N/A	N/A	N/A	N/A
South Africa	17	24	12.5	3000000	63.5	17	14	35	32
Angola	N/A	4	4	1230000	31	N/A	N/A	N/A	N/A
Malawi	3	5	3	436500	14.5	87	87	5	5
Mozambique	6	9	7.3	N/A	N/A	84	83	7	8
Mauritius	1	1	N/A	1000000	N/A	27	17	28	43
Tanzania	9	15	12.5	N/A	5.7	86	84	4	5
Zambia	3	5	3.86	376900	10.0	76	75	8	8
Zimbabwe	4	6	4	1124000	30	32	68	12	8

Source: World Development Report, 1996; SADC 1993.

\*Figures include citizens employed in South African mines.

In Botswana and South Africa, at least 50 percent of the economically active population are formally employed, compared to 30 percent in Zimbabwe and 10 percent or less in the other countries for which data is available. One likely consequence of low formal wage percentages is relatively low incomes and small domestic markets. Disproportionately high agricultural/primary sector employment also means low incomes, since the terms of trade often favor industry over agriculture. The exceptions to this are Mauritius, South Africa and Lesotho.

Because of large subsistence sectors, and in particular the low participation by women in the formal wage economy, the 15-64 age group is significantly greater than the economically active populations in most SADC countries.

### **5. Urbanization of Population**

Excluding Mauritius, all the southern African countries have experienced a dramatic rise in urbanization of the population. This data is summarized in Table 4.5.

**Table 4.5. Urban Population**

	Urban Population as % of Total Population		Average Annual Growth Rate	
	1980	1994	1980	1994
Botswana	15	13	8.9	7.6
Lesotho	15	22	6.8	6.1
Namibia	23	36	6.2	6.2
South Africa	43	50	2.7	2.9
Malawi	9	13	6.1	5.7
Mauritius	42	41	0.4	1.4
Mozambique	13	33	9.1	7.4
Tanzania	15	24	6.8	6.4
Zambia	40	43	4.2	3.6
Zimbabwe	22	31	6.0	5.9
Burundi	4	7	6.9	6.7
Ethiopia	10	17	4.7	3.2
Kenya	16	27	7.5	6.1
Madagascar	18	26	5.7	5.7
Uganda	9	12	4.9	5.6

Source: World Development Report, 1996.

Given the slow growth in formal employment, as indicated in the previous table, this trend implies urbanization without industrialization.

## 6. Labor Migration in SADC Countries

Table 4.6 summarizes the average number of employees from SADC countries employed in South African mines. While this table shows only those employed in mines, there is a large interchange of labor in southern Africa, particularly migration toward the more prosperous countries like South Africa, Botswana and Zimbabwe.

**Table 4.6. Average Number of Employees in South African Owned Mines (Gold and Copper)**

	1975	1977	1981	1985	1990
Botswana	N/A	N/A	17543	18088	14920
Lesotho	N/A	N/A	110542	107447	103920
Swaziland	N/A	N/A	9480	13013	16834
Angola	3431	1043	-	-	-
Malawi	27904	3495	13809	18102	70
Mozambique	97216	36922	4148	51698	44408
Zimbabwe	2485	18653	2968	5	2
<b>SUBTOTAL:</b>	<b>131036</b>	<b>60113</b>	<b>158492</b>	<b>208353</b>	<b>180154</b>
<b>South Africa</b>	<b>101553</b>	<b>189106</b>	<b>240082</b>	<b>393788</b>	<b>257698</b>
<b>TOTAL:</b>	<b>232589</b>	<b>249218</b>	<b>399915</b>	<b>512416</b>	<b>437852</b>

Source: SADC, "Regional Relations and Cooperation Post-Apartheid," 1993.

Except for Zambia and Tanzania, all SADC countries have depended on official migrant labor to South Africa. Although migrant mine labor decreased in most countries in the 1990s, unofficial labor trekking to South Africa has not declined. In 1996, an estimated 12,000 Zimbabweans who went to South Africa on

6-month visa permits over a two-year period had not returned. Mozambique had almost 60,000 “official” migrant workers in South Africa.<sup>108</sup>

One reason for the continued “export” of labor to South Africa is higher wages from both official and illegal employment. Migration is a source of household income and government foreign exchange for citizens who would otherwise be unemployed.

### **7. Inflation and Purchasing Power Parity (PPP)**

Inflation and PPP statistics in Table 4.6 show that those countries with relatively stable prices have higher PPP. One implication of inflation for regional trading blocs is the cross importation of inflation.

**Table 4.7. Inflation and Price Indices and Purchasing Power Parity (PPP) of GNP**

	Average Annual Inflation Rate (%) (GNP Deflator)			Purchasing Power Parity (PPP)* US\$=100		
	1965- 1980	1980- 1990	1984- 1994	1987	1994	GNP per capita, (Intl. \$) 1994
	8.4	12.0	11.7			
Botswana	8.4	12.0	11.7	15.4	2.1	5210
Lesotho	6.7	12.7	14.0	6.6	6.7	1730
Namibia	N/A	13.4	10.6	17.0	16.7	4320
South Africa	10.3	14.4	14.3	23.9	19.8	5130
Angola	N/A	400.0	900.0	N/A	N/A	N/A
Malawi	7.4	14.7	18.8	3.1	2.5	650
Mozambique	-	36.6	58.3	27	1.7	430
Tanzania	9.6	25.8	33.3	2.6	2.4	620
Zambia	6.3	42.2	92.0	4.1	3.3	860
Zimbabwe	5.8	10.8	19.7	8.7	7.9	2640
Burundi	5.0	4.2	5.4	3.4	2.7	700
Ethiopia	3.4	2.1	N/A	2.0	1.7	430
Kenya	7.2	9.2	11.7	5.7	5.1	1310
Uganda	21.4	107.0	75.0	5.0	5.4	1410
Madagascar	17.7	17.1	15.8	3.1	2.5	640

Source: World Development Report, 1992; 1996; IBC USA Licensing Inc., 1996.

\*The Purchasing Power Parity figures are in GNP, not in GDP, as is consistent with the World Bank Atlas-based estimates.

<sup>108</sup>PANA, October 29, 1996; PANA, January 2, 1997.

Within the region, the country with the highest purchasing power is Mauritius, followed by South Africa. PPP in Mauritius, Botswana, Lesotho and Uganda improve over time, while PPP in the rest of the countries decline.

Angola had the highest inflation rate in 1984-94, followed by Zambia. Inflation decreased in the remaining countries.

The wide fluctuations in inflation rates calls for coordinated macroeconomic policies in a regional trade setting. Yet, coordinated macroeconomic policies are likely to affect small and large countries differently. It is certain to affect Balance of Payment (BOP) levels and movement of goods and services, particularly production inputs. Imports of raw materials for export production would also affect the price of exports, hence negatively impacting the terms of trade.

## **B. EXTERNAL TRADE**

### **1. Summary of Exports of Goods and Services**

In absolute terms, South Africa clearly dominates the region in export capacity, followed by Botswana and Zimbabwe. However, it is Mauritius and Botswana whose exports contribute the highest proportion of GNP. South Africa and Mauritius are the only countries who have had consistently positive growth in exports between 1980 and 1994. Most other counties showed an upward trend in the 1990s, while Zimbabwe suffered a decline of 6.6 percent; this coincided with South Africa's restrictions on Zimbabwean exports. This data is shown in Table 4.8.

**Table 4.8. Summary of Exports of Goods and Services**

	Total Exports (\$M) (at constant 1987\$)		Total Exports as % of GDP		Manufactures as % of Total Exports		Average Annual Export Growth Rate (%)	
	1980	1994	1980	1994	1980	1993	1980- 1990	1990- 1994
Botswana	502	1845	53	52	N/A	N/A	11.4	-0.8
Lesotho	N/A	N/A	20	15	N/A	N/A	N/A	N/A
Namibia	N/A	1321	76	53	N/A	N/A	N/A	N/A
South Africa*	25530	25949	36	24	39	94	2.8	7.0
Malawi	295	325	25	29	7	4	0.1	-1.8
Mauritius	431	1347	51	59	27	90	8.6	2.0
Mozambique	281	-	14	24	2	20	-10.5	-0.3
Tanzania	511	519	11	12	14	-	-3.5	26.9
Zambia	1300	1080	N/A	N/A	6	9	-1.8	10.0
Zimbabwe	1410	1870	30	39	18	38	2.2	-6.6
Burundi	65	106	9	14	3	10	7.4	-4.8
Kenya	1250	1609	28	39	12	29	-1.4	3.9
Madagascar	401	277	13	22	6	20	2.6	16.6
Uganda	345	421	19	8	3	1	-1.4	3.9
Angola	N/A	3000	-	-	-	-	-	-

Source: World Development Report, 1992; 1996; South Africa Reserve Bank Annual Economic Report, 1996.

\*South Africa's figures include SACU member countries. However, there are limited statistics on Botswana, Namibia and Lesotho.

The data also reveals an inverse ratio between exports as a percentage of GNP and domestic market size. South Africa's total exports have progressively declined in importance relative to GDP. This is consistent with its large domestic market. However, the share of manufactured exports rose rapidly until 1993. The relative increase in export's contribution to GDP reflects increases in manufactured exports as most southern African countries liberalize trade. It is important to note that those countries with close trade relations to South Africa (Botswana, Malawi, Zimbabwe, and Mozambique) had negative export growth rates during the 1990. South Africa's exports grew by seven percent. This was the period during which South Africa was under international trade sanctions, which likely reduced her imports.

## 2. Structure of Imports

Although the magnitudes vary, all countries had fluctuating import growth rates, as shown in Table 4.9. The larger increases across the region were mainly in goods relative to services. This reflects the relatively low level of economic development and industrialization. In 1994, the largest relative upswings in total imports were in Uganda, Tanzania and South Africa. Zimbabwe, Zambia, Kenya, Madagascar and Botswana had large contractions. The contraction of imports in southern Africa resulted from foreign exchange shortages, import substitution, disruption of economic activity during civil wars, and poor agricultural seasons.

**Table 4.9. Structure of Imports**

	1980			1994			Average Annual Growth Rate (%)	
	Goods	Services	Total	Goods	Services	Total	1980-1990	1990-1994
Botswana	692	262	954	1638	458	2096	7.7	-5.6
Lesotho	464	18	482	-	N/A	N/A	-	-
Namibia	-	-	N/A	196	610	806	-	-
South Africa	19600	6389	25989	23400	6819	30215	+0.8	-5.3
Angola	N/A	N/A	N/A	N/A	N/A	16300	-	-
Malawi	439	199	638	491	148	639	0.7	-0.6
Mauritius	609	103	712	1926	459	2385	11.2	2.5
Mozambique	800	75	875	1000	403	1403	-1.0	2.9
Tanzania	1250	162	1412	1505	562	2067	-3.3	12.7
Zambia	1340	647	1987	-	-	1953	-	-
Zimbabwe	1450	450	1900	-	-	2338	-2.2	-5.1
Kenya	2120	975	3095	2156	688	2844	1.6	-5.6
Madagascar	600	30	630	434	687	1121	-4.6	-5.6
Uganda	293	157	450	870	31	901	-0.6	28.7

Source: World Development Report, 1996.

For export dependent economies, any contraction in imports of production inputs reduces the capacity to export, hence perpetuating the cycle of low export growth.

South Africa's export of services nearly doubled between 1980 and 1994, while the rest of the countries in the region registered modest increases. Imports in South Africa decreased over the period, while countries such as Mauritius showed increases. This can be seen in Table 4.10. The main service sectors in smaller southern African countries are tourism and migrant labor, whereas South Africa exports tourism and know-how.

**Table 4.10. Share of Services in Imports and Exports (%)**

	1980		1994	
	Exports	Imports	Exports	Imports
Botswana	32	27	22	22
Lesotho	84	4	N/A	N/A
South Africa	8	25	15	23
Malawi	6	31	17	23
Mauritius	24	14	31	19
Tanzania	32	11	39	19
Zambia	20	33	N/A	N/A
Zimbabwe	18	27	-	-
Kenya	39	32	-	-
Madagascar	23	-	40	24
Ethiopia	28	-	56	-
Uganda	4	35	34	-
Namibia	N/A	N/A	27	76

Source: World Development Report, 1996.

### 3. External Indicators

Table 4.11 summarizes three measures of a country's export position: export concentration rates, terms of trade, and balance of payments. The export concentration ratio measures the diversity of a country's exports. The higher the export concentration index, the fewer the number of goods within a product classification of a country's foreign trade. The terms of trade show a declining trend,

except for Mauritius, Mozambique and SACU. The BOP deficits have persisted for most countries from the 1980s to the 1990s.

**Table 4.11. External Indicators**

	Export Concentration Index		Terms of Trade 1987 = 100		Balance on Current Account as % of GNP (before transfers)	
	1984	1992	1985	1994	1980	1994
Botswana			97	152	-22.5	4.4
Lesotho					17.8	-26.6
Namibia					-	-0.6
South Africa*	0.457	0.378	101	102	4.9	-0.2
Malawi	0.530	0.704	97	87	-27.4	-44.0
Mauritius	0.656	0.332	77	121	-11.1	-6.8
Mozambique	0.274	-	113	124	-20.7	-71.4
Tanzania	0.359	0.248	126	83	-4.8	-6.9
Zambia	0.844	0.787	89	85	-14.5	-0.20
Zimbabwe	0.295	0.329	100	84	-4.8	-3.7
Burundi	0.776	-	153	82		
Ethiopia	0.622	0.557	119	74		
Kenya	0.340	0.305	124	80	-48.9	-15.6
Madagascar	0.466	0.285	124	82		
Uganda	0.932	0.561	149	58	-	-6.7

Source: World Development Report, 1992; 1996; IBC Licensing USA.

\* Figures include those from SACU countries.

## C. INVESTMENT AND RESOURCE FLOWS

### 1. Domestic Savings and Investment

As seen in Table 4.12, most southern African countries were unable to save enough to fund their domestic investment, with the exception of Kenya and Botswana. South Africa, Zimbabwe and Mauritius were inconsistent in the investment-savings balance.

**Table 4.12. Domestic Investment and Savings**

	Domestic Investment as % of GNP		Domestic Savings as % of GNP	
	1990	1994	1990	1994
Botswana	N/A	25	N/A	25
Lesotho	71	86	-41	-14
Namibia	N/A	20	N/A	17
South Africa	19	18	25	20
Malawi	19	16	10	-1
Mauritius	30	32	21	23
Mozambique	37	60	-12	5
Tanzania	25	31	-6	3
Zambia	14	7	17	4
Zimbabwe	21	22	21	17
Burundi	19	9	1	-10
Ethiopia	13	15	6	3
Kenya	24	21	18	24
Madagascar	12	N/A	8	-1
Uganda	12	14	-	4

Source: World Development Bank, 1992; 1996; South Africa Reserve Bank, 1996.

## 2. Stock Market Trade

Stock markets mobilize both domestic and foreign resources for short term finance, which helps alleviate domestic savings shortages. Table 4.13 shows the number of companies offering stock in each country of the region, and the overall turnover ratio.

**Table 4.13. Number of Companies Listed and Turnover Ratio (1996)**

	Number of Stocks	Turnover Ratio (%)
South Africa	640	6.5
Zimbabwe	64	7.6
Kenya	56	2.8
Mauritius	28	4.6
Botswana	12	10.0
Namibia	10	1.6
<b>Rest of Africa:</b>		
Nigeria	181	0.8
Cote d'Ivoire	31	2.8
Ghana	19	1.3

Source: Standard Chartered Bank, "Africa Quarterly Review," September 1996.

The number of companies listed in Zimbabwe is 10 percent that of South Africa. Compared to the rest of Africa, southern African stock markets are relatively more developed and active. Nevertheless, stock market finance has little employment growth potential.

### 3. External Financing

As can be seen in Table 4.14, many economies in southern Africa are dependent on aid, including Mozambique, Tanzania, Uganda, Burundi, Ethiopia, Zambia and Malawi. Given that aid-funded projects tend to be less productive than private investment, this dependence on aid invariably reduces the opportunities for sustained economic growth and increased income.

**Table 4.14. Official Development Aid and Other Resource Flows**

	Official Development as % of GNP		Net Private Capital Flows (US\$ millions)	
	1980	1994	1980	1994
Botswana	11.8	2.2	114	-50
Lesotho	14.9	8.3	7	14
Namibia	0.0	5.9	-	-
South Africa*	N/A	N/A	4755	6000
Malawi	12.6	37.0	30	-1
Mauritius	2.9	0.4	49	124
Mozambique	8.4	100.1	0	32
Tanzania	12.4	30.3	100	12
Zambia	8.9	22.3	175	-4
Zimbabwe	3.1	10.1	23	-70
Burundi	12.8	32.2	-3	-1
Ethiopia	4.7	22.9	26	-12
Kenya	5.6	10.2	301	-272
Madagascar	5.8	16.0	131	2
Uganda	9.0	18.3	54	-11

Source: World Development Report, 1992; 1996; South African Reserve Bank, 1996.

\*In the case of South Africa, the figures are for 1983.

Net private capital flows have been falling dramatically across southern Africa, save in Mauritius, South Africa, Mozambique and Lesotho. With the exclusion of South Africa, sub-Saharan Africa only attracted 1.7 billion US\$ in foreign investment

in 1993. Seventy percent of this went to oil projects in Nigeria and Angola. Others note that while the world total of foreign direct investment increased six fold from 1987 to 1994, the share in southern Africa fell 10 percent in 1987 and 3.7 percent in 1994. This compared to east Asia's net increase of 34.9 percent and 55.3 percent, respectively.<sup>109</sup>

Table 4.15 shows that within SADC, only Botswana has maintained a budget surplus from 1985 to 1994; the deficit in Mauritius is negligible. Zimbabwe has had the largest relative deficits in the region. This, combined with a BOP deficit, negatively impacts the country's overall export performance.

**Table 4.15. Government Budget Surplus as a Percentage of GNP**

	1980	1985	1990	1994
Botswana	-0.2	17.2	12.6	11.2
Lesotho	N/A	-0.9	-2.8	N/A
Malawi	-17.2	-5.5	-1.9	N/A
Namibia	N/A	N/A	7.0	-4.7
Mauritius	-10.4	-	-0.5	-0.3
Swaziland	6.6	N/A	N/A	N/A
Tanzania	-7.0	N/A	N/A	N/A
Zambia	-20.0	-7.0	-5.0	-7.3
Zimbabwe	-11.1	-9.9	-7.9	-15.6
South Africa	-0.2	N/A	-2.5	-9.2
Kenya	-4.6	N/A	-6.8	-3.6

The government budget deficit financed through domestic borrowing tends to crowd out private sector investment, push up interest rates, and consequently increase

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<sup>109</sup>PANA, February 25, 1997; Standard Chartered Bank, Africa Quarterly Review, April 1995. Nevertheless, there seems to be an upward trend in foreign investment in Zimbabwe. See PANA, UNCTAD Recognizes Zimbabwe's Performance, Baker, Senegal, May 9, 1997.

production costs, including those for exports. This further reduces the country's competitiveness.

#### D. PUBLIC SECTOR PARTICIPATION

Public sector participation can be estimated using total government expenditures, i.e., total recurrent and capital expenditures relative to GNP. (See Table 4.16) The level of participation has been high in South Africa, Botswana, Zimbabwe and Kenya. Nevertheless, most countries are privatizing and/or commercializing public enterprises.

**Table 4.16. Public Sector Participation**

	Total Government Consumption as % of GNP			
	1972	1980	1990	1994
Botswana	33.7	36.5	42.2	40.2
Lesotho	16.6	-	25.1	39.8
Namibia			42.8	
South Africa*	22.7	23.2	34.6	36
Malawi	22.1	37.6	29.2	N/A
Mauritius	16.3		24.2	
Mozambique	N/A	N/A	N/A	N/A
Tanzania	19.7	29.6	N/A	N/A
Zambia	34.0	40.0	21.9	21
Zimbabwe	-	35.3	40.5	45
Burundi	19.9	22.6	N/A	N/A
Ethiopia	13.7	N/A	N/A	N/A
Kenya	21.0	26.1	31.4	31.4
Madagascar	16.7	N/A	19.4	N/A
Rwanda	12.5	14.3	N/A	N/A
Uganda	21.8	6.1	N/A	N/A

Source: World Development Report, 1992; 1996; Standard Chartered Bank, "Business Trends - Zimbabwe," August 1996.

## **V. ZIMBABWE IN SOUTHERN AFRICAN REGIONAL TRADE ARRANGEMENTS**

In Chapter III, it was noted that the current Zimbabwe-South Africa trade negotiations are two-pronged: reviving and broadening the 1964 preferential bilateral trade agreement, and transforming the Southern African Development Community (SADC) into a free trade area over 8 years, culminating in a common market. It was also noted that Zimbabwe and South Africa belong to other overlapping, higher-level regional trade agreements: the COMESA and SACU.

The bilateral trade arrangement covers specific sectors, including textiles and clothing, footwear, agricultural products and light manufactures. The negotiations have been slow and controversial, but the two countries agreed to reduce tariffs on textiles from 90% to 30% over five years. Nothing tangible has been achieved in other sectors.<sup>110</sup>

On the regional level, the SADC Trade Protocol was signed in March 1997. It will establish a free trade area in 8 years, but will take effect only after technical details have been finalized. The SADC free trade area would culminate in an economic community, which subsumes a customs union.<sup>111</sup> On the other hand, COMESA should achieve free trade status in 5 years.

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<sup>110</sup>Zimbabwe proposed an immediate restoration of the pre-1992 tariff levels, and the broadening of the agreement to include tariff items excluded from the 1964 agreement, increasing quotas and converting quotas from value to volume terms. Zimbabwe also proposed extending the rules of origin to include SADC produced content. South Africa refused to reduce tariffs to the 1964 levels, or to consider extending the rules of origin beyond SACU members of SADC.

<sup>111</sup>South Africa favored a longer transition period, arguing that the free trade arrangement would do more harm than good in other countries, but was overruled by the 11 members. SADC, Made in SADC, <http://www.sadcexpo.org/news12.html>.

## A. TRADE POLICIES OF ZIMBABWE AND SOUTH AFRICA

In the 1980s, Zimbabwe's trade policies included export incentive schemes, and cash export retention schemes to encourage exports. Zimbabwe also protected domestic industries through restrictive tariffs and quotas. In the 1990s, several export promotion schemes were introduced. These notable schemes include a policy which allowed exporters to retain 50% of their export earnings to finance investment, and the export support facility to benefit those ineligible for the export retention scheme, and a 30% manufacturing export bonus.<sup>112</sup>

Beginning in 1991, Zimbabwe started liberalizing trade, and reduced or removed most of the export subsidies and import restrictions in line with GATT. Import licencing has stopped. On average, import duties were set at about 30%, but remained relatively high on cars, some commercial vehicles, batteries and clothing. Zimbabwe also moved from non-tariff barriers (NTBs) to tariffs. In March 1997, Zimbabwe further reduced tariffs, especially on items required by the manufacturing sector; tariffs on capital goods were reduced to zero (except on motor vehicles), to between 5-15% on tools, 0-20% on raw materials, a maximum of 30% on intermediate goods, and a flat 15% on spares. In May 1997, Zimbabwe's president, Robert Mugabe also called on Southern African countries to remove trade barriers, indicating each country's commitment to liberalized trade in the region.<sup>113</sup> A new export drive includes export processing zones (EPZs) which provide tax holidays, waivers of custom duties and transfer taxes.

Before 1994, South Africa's trade policy included import controls, direct export subsidies and R&D assistance. Import restrictions included tariffs and NTBs covering all sectors; restrictions were more restrictive in agriculture, textiles, clothing

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<sup>112</sup>IBC USA Licensing Inc, 1996.

<sup>113</sup>Pan African News Agency, Mugabe Calls on Southern Africa to Remove Trade Barriers, PANA, Dakar, Senegal, May 5, 1997.

and manufactured goods. NTBs included surcharges on imports, in some cases as high as 100%, anti-dumping policies, health requirements, quotas, licencing and retaliation practices. Under the Terms of Import and Export Control of 1963, the Minister of Trade can act in the national interest to prohibit, ration or otherwise regulate imports. For example, tariffs on steel products have been increased by as much as 180% under this provision. Local content restrictions have been tightened in certain industries, notably in vehicle manufacturing.<sup>114</sup> While Zimbabwe discontinued cash incentives for manufacturers, South Africa inaugurated a major incentive scheme for its regional exports. Consequently, South Africa took some markets from Zimbabwe.<sup>115</sup>

The new trade regime reduces some tariffs (clothing) to 45% over 12 years and vehicle duties from 100% to 50% over 5 years.<sup>116</sup> Export subsidies are administered through the General Export Incentive Scheme (GEIS). This scheme provides up to 25% cash incentives on f.o.b. value. While this scheme was to be scrapped by 1995, some export subsidies are still in place and hurting regional trading partners.<sup>117</sup> Also in place is the export marketing scheme, started in 1990, giving cash assistance for primary market research, trade exhibition and trade mission participation. Another incentive scheme is the customs tariff-exempt export development financing.<sup>118</sup>

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<sup>114</sup>US Department of Commerce, Survey of Current Business, Vol. 71, No. 8, Table 11.3, August 1991.

<sup>115</sup>Libby, Ronald T., The Politics of Economic Power in Southern Africa, Princeton University Press, Princeton. 1987.

<sup>116</sup>IBC USA Licencing Inc., 1 September, 1996.

<sup>117</sup>Recently, the Zambian Association of Manufacturers complained about the effect of South African subsidies on the Zambian manufacturing sector. "SA Goods Clamp Down," Mail & Guardian News, April 16, 1997.

<sup>118</sup>US Department of Commerce, "Survey of Current Business," Vol. 71, No. 8, Table 11.3, August 1991.

Without adequate data, it is difficult to conclude which of the two countries has the higher effective rate of protection. However, on the items mentioned above, it is evident that South Africa's duties and export incentive schemes exceed those of Zimbabwe.<sup>119</sup>

Tariffs can be restrictive or protective. Restrictive tariffs are designed to reduce imports, while protective tariffs protect domestic industry from competing imports. Restrictive tariffs have two effects: cutting consumption of the imported good and increasing domestic production. Problems inherent in tariff measurement present additional problems for estimating the degree of protection. The height of tariffs is difficult to measure restrictiveness, nor can tariffs levels be measured with the desired precision. The most common measurement problems are:<sup>120</sup>

- ◆ Differences in nomenclatures make it difficult to measure the effect of tariffs even if identical measures are used.
- ◆ Unweighted averages are superior to weighted averages. Weighted averages distort results since totally prohibitive tariffs are given a weight of zero (they do not even appear), and low duties are given large weights.
- ◆ Additionally, tariff measures do not capture the differential impact between participating and non-participating countries. Within a customs union, low-tariff countries will find it easier to encroach upon the markets of high tariff members than South Africa, while for non-participants the most negative impact is on those countries previously trading with the low tariff union members.
- ◆ Measurement may also be complicated by the divergent size and structure of industries. In small countries, quantitative restrictions applied to relatively small range of import values can protect a

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<sup>119</sup>Repeated requests for tariff information from both Zimbabwe and South Africa was abandoned because the respective customs organizations insisted the writer pay for the documents; these references were not readily available from local resources.

<sup>120</sup>Balassa, The Theory of Economic Integration, Richard D. Irwin, 1961; see also, Margaret Kelly and Annie, K. McGuirk, "Issues and Developments in International Trade Policy," International Monetary Fund: World Economic and Financial Surveys, Washington, D.C., August 1992.

relatively large portion of domestic production. The smaller the country, the smaller the quantitative restrictions required to provide high protection. The coverage of quantitative restrictions indicate only the existence of one or more restrictions, but do not show the scarcity of the value they restrict.

- ◆ Reducing duties on inputs but not on final goods expands protected production and may increase the effective rate of protection of final import-competing goods.<sup>121</sup>
- ◆ Aggregation also conceals some important differences within tariff items, such that saying that materials have an average tariff of 55% when some are subject to 0% and others are at 90% exaggerates the harmony.
- ◆ Trade is not only restricted by tariffs; the non-tariff barriers are varied and even more difficult to quantify.

## 1. Trade Relations in the Eastern and Southern African Region

### a. *Exports of Selected Southern African Countries By Industrial Origin*

Table 5.1 shows that the major exporters in southern Africa are in South Africa-dominated SACU, Zimbabwe, Mauritius, and Kenya. Southern Africa has a strong bias toward agriculture and mineral-based exports. Apart from SACU/South Africa, the composition of exports is similar across countries, with most specializing in natural resource-based products and light manufacturing. They differ primarily in proportion and magnitude. In SACU, the largest exporting sub-sectors are other manufactures (including arms, gold and diamonds), followed by metal manufactures and base metals. Textiles, food and beverages and tobacco are also significant.

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<sup>121</sup>Kelly, Margaret, and Annie K. McGuirk, "Issues and Developments in International Trade Policy," International Monetary Fund: World Economic and Financial Surveys, Washington, D.C., August 1992.

**Table 5.1. Exports of Selected Southern African Countries by Industrial Origin (% of Total Value)**

	SACU*		ZIMBABWE		MAURITIUS		KENYA	
	1992 100	1993 100	1992 100	1993 100	1992 100	1993 100	1992 100	1993 100
Total								
1. Agriculture	4.5	4.1	42.0	39.4	1.4	1.4	42.0	49.8
2. Mining/Quarry	18.6	22.1	7.7	6.3	1.6	1.8	2.0	2.6
3. Manufacturing	76.9	73.8	50.3	54.4	96.9	96.7	56.0	47.6
31. Food/Bev/ Tobacco	3.9	3.4	5.4	8.4	30.1	28.4	7.0	8.8
32. Textiles	2.7	2.5	10.6	10.3	54.5	59.5	3.4	4.3
33. Wool/Products	0.5	0.7	1.0	1.3	0.2	0.1	0.3	0.6
34. Papers/Products	2.9	2.5	0.6	1.9	0.3	0.1	0.7	1.5
35. Chemicals	5.9	5.4	3.5	4.0	3.0	1.1	15.3	14.9
36. Non-metal minerals	0.9	0.8	0.9	1.0	0.2	0.3	1.4	2.8
37. Base Metals	11.4	9.3	21.4	17.6	0.1	0.0	2.4	4.8
38. Metal Manufac- turers	8.4	8.8	5.4	8.0	4.4	3.6	3.0	3.2
39. Other Manufac- turers	40.4	40.4	1.6	2.0	4.2	3.5	22.5	6.7

\*SACU figures comprise mainly those of South Africa.

Source: UN International Trade Statistics Yearbook, Trade by Country, 1994.

Zimbabwe's strongest exporting sub-sectors (excluding gold) are base metals, textiles, food and beverages, and tobacco. Mauritius' exports are predominantly textiles and food and beverages. Kenya's strongest sectors are chemicals, food and beverages, tobacco and textiles. With such a pattern, trade competition, like protectionism and subsidies, becomes inevitable, unless measures are taken to improve interdependence and complementarity.

*b. Imports of Selected Eastern and Southern African Countries*

The composition of imports, as shown in Table 5.2, indicate a similar pattern to exports. As shown in Table 5.1, only Zimbabwe exports a limited amount of industrial inputs, but her potential to meet South Africa's processed industrial inputs is limited, given the higher industrialization in South Africa. On the other hand, South Africa may be able to supply some, if not most, of their industrial inputs requirements.

**Table 5.2. Imports of Selected Southern African Countries, by Broad Economic Category (% of Total Value)**

	SACU*		ZIMBABWE		MAURITIUS		KENYA	
	1989	1993	1990	1993	1990	1993	1990	1993
1. Food/Bev	2.5	4.8	2.4	6.0	11.6	12.8	8.8	12.1
11. Primary	1.0	2.3	1.7	2.7	4.5	5.3	4.1	5.0
12. Processed	1.4	2.5	0.7	3.3	7.1	8.0	4.6	7.1
2. Industrial Supplies	24.5	29.4	35.9	36.9	44.3	46.9	27.2	35.9
21. Primary	3.0	4.5	2.3	7.6	3.6	3.4	2.3	2.7
22. Processed	21.5	24.9	33.6	29.4	38.8	43.1	25.0	33.2
3. Fuels	N/A	0.2	15.1	14.3	7.5	6.7	19.4	14.5
4. Machinery	3.7	28.9	22.7	22.5	12.3	13.5	20.5	16.5
5. Transport	20.8	28.9	15.4	14.2	13.7	7.0	19.5	10.8
6. Consumer Goods	6.2	10.3	5.6	4.3	9.9	12.9	5.6	8.7
Other Goods	12.4	9.0	3.0	1.7	0.3	0.3	0.7	1.5
Total					100	100	100	100

Source: UN International Trade Statistics Yearbook, Trade by Country, 1994.

\*SACU figures mainly comprise those from South Africa

The data in Table 5.3 shows that Zimbabwe dominated exports to SACU in 1992, mainly to South Africa. Zimbabwe contributed 39.9% of agricultural exports, and 19.7% of textile exports. The high textile component partly reflects the

relatively low wages in Zimbabwe; Zimbabwe's preeminent position also results from the bilateral trade arrangement with South Africa. The rest of the region's exports to SACU were negligible.

**Table 5.3. Imports of SACU from the Rest of Southern Africa**

January to June 1992

	Value (R000)*	% Total from Region	Zimbabwe Total (R000)	% of Zimbabwe Total	Zimbabwe % Regional Total
1. Agricultural Products	218462	44.1	154537	39.9	70.7
2. Mineral Products	32823	6.6	32245	8.3	98.2
3. Chemical Products	6955	1.5	65.8	1.7	93.7
4. Plastics/Rubber Products	7988	1.1	52.4	1.3	64.1
5. Hides, Skins, and Leather	8820	1.9	7983	2.0	9.5
6. Wood & Products	20710	4.4	16797	4.3	81.1
7. Paper & Products	3381	0.6	3346	0.9	99.0
8. Textiles	97633	19.7	72979	18.7	74.7
9. Footwear	12514	2.6	12514	3.2	100.0
10. Stone & Related	2935	0.7	2933	0.7	99.9
11. Article of Base Metals	40009	8.1	36366	9.3	90.9
12. Machinery/ Appliances	22180	4.5	21541	5.5	97.1
13. Veh & Related	11359	2.3	7106	1.8	62.6
14. Misc Mfres	6528	1.3	6496	1.6	98.1
15. Officials	583	>0.1	354	>0.1	60.7
Art	76	>0.1	70	>0.1	92.1
Unclassified	2053	0.4	1855	0.5	90.3
Total	495696	389098			78.5

\*1U\$ = 4.5 Rand.

Source: SADC: Regional Cooperation Post Apartheid, 1993.

Table 5.4 summarizes the bilateral trade relations between Zimbabwe and South Africa in 1993. South Africa's imports are mostly primary-based products,

**Table 5.4. South African Imports and Exports: Zimbabwe in 1993 (By Order of Importance)**

Imports	R (million)	Exports	R (million)
24. Tobacco	60.5	84. Boiler/Machinery Appliances	293.4
52. Cotton	54.3	87. Motor Vehicles	166.6
25. Salt, Sulphur Lime & Cement	40.8	Nickel & Related Articles	132.3
44. Wood/Charcoal	38.4	Iron/Steel	119.1
12. Seeds/Grain	36.8	Plastics & Related Articles	100.2
64. Footwear	34.3	Products of Chemicals	84.7

Source: Holden, Merle, "Economic Integration and Trade Liberalization in Southern Africa," Is There a Hole for south Africa, World Bank Discussion Paper Number 342, 1996. Quoted with permission from World Bank. 1 US\$ = 4.5 Rand.

rather than capital goods. Trade between the two countries seems to be inter-industry. However, South Africa is also a major exporter of the goods that Zimbabwe exports to South Africa, as shown in Table 5.1. Thus, trade in some of the sectors is actually intra-industry, hence competitive. Also of note, Zimbabwe imports critical production inputs, which naturally tend to be demand inelastic. Where the inputs are differentiated, Zimbabwe's imports tend to be tied to South African suppliers. In contrast, the natural resource-based imports from Zimbabwe are relatively more price elastic. Furthermore, Zimbabwe has an incentive to lower trade barriers on production inputs, so as to minimize production costs.<sup>122</sup> On the other hand, South Africa's imports are largely consumption goods. South Africa would have little incentive to

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<sup>122</sup>To do otherwise would be 'shooting one's own foot' since this would lead to higher prices, with negative consequences on export competitiveness.

lower trade barriers on imports from Zimbabwe, because these products can be replaced by domestic production.

Because of high trade restrictions, Zimbabwe faces in the developed countries for commodities like textiles, clothing, and agricultural products, and the limited markets due to low incomes in the rest of sub-Saharan Africa, South Africa becomes the most logical alternative.<sup>123</sup>

Table 5.5 summarizes the direction of trade, in value terms, for 1995. Clearly, South Africa dominates two-way trade with all the countries of the region. Within southern Africa, Zimbabwe remains South Africa's major trading partner, accounting for 29% of exports. From a global level, Zimbabwe remains a small market for South Africa. Zimbabwe receives about 8% of South Africa's exports and provides around 1% of total imports. South Africa's other important export markets are Mozambique, Zambia, Kenya, and Malawi, in order of importance.

Like South Africa, Zimbabwe had a trade surplus with all her regional trading partners except South Africa during the same period. Zimbabwe also remains South Africa's nearest challenger for regional trade. Exports to South Africa were at 20% of Zimbabwe's total world exports, compared to 18% to the rest of Africa. The other main regional markets include Botswana, Malawi, Mozambique, Tanzania, and Kenya, in order of importance. Of her total exports to Africa, South Africa received 35%; SADC accounted for 38%. Imports from South Africa, 29%, were lower than the total from the rest of Africa (31%). As to be expected for countries at different levels of industrialization, South Africa, Zimbabwe, Kenya and Mauritius had triangular trade patterns, exporting to less developed countries and importing from developed countries. Also, the trade balance favored the relatively more developed countries. For Zimbabwe, two-way bilateral and regional trade is vital; for South Africa, export markets are relatively more important.

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<sup>123</sup>See Tables 4.1 and 4.4 for market sizes, GNP per capita and unemployment statistics.

**Table 5.5. Direction of Trade in Selected Eastern and Southern African Countries (US \$ Millions), 1995**

Importer	South Africa	Zimbabwe	Kenya	Mauritius	Mozambique	Malawi	Zambia	SADC*	COMESA**	Africa	ROW
Exporter											
South Africa	852	230	188	437	215	461	2314	2769	2971	28809	1326
Zimbabwe	287	18	7	75	96	81	764	885	803	803	1326
Kenya	10	5	14	1	3	4	223	559	581	1351	
Mauritius	5	8	4	-	1	2	18	28	63	1389	
Malawi	64	4	2	-	4	5	85	28	112	327	
Mozambique	32	6			4		43	11	50	191	
Zambia	19	27	2		4		64	85	110	1018	
**Uganda	1		7	11	3	2	3	3	10	11	471
**Tanzania	5	1								97	622
**Botswana				7							
**Zaire	122			2						155	1316
**Angola		6	1							12	3312

\* All figures are f.o.b.

\*\* Only export figures are shown; not what the country imports.

\*\*\*The totals include data for countries not shown in table due to space limitations.  
ROW means rest of the world.

Source: IMF: Direction of Trade Statistics, Yearbook, 1996.

The proximity effect is evident in southern and eastern African countries, especially Tanzania, Uganda and Kenya. Another notable feature is the limited trade between Angola and the rest of the region, except for imports from South Africa and Zimbabwe.<sup>124</sup> Finally, the direction of trade statistics show that while South Africa is not member of COMESA, her trade with those countries exceeds Zimbabwe's intra-COMESA trade. It may just be a matter of time before South Africa either joins COMESA or enters bilateral trade agreements to protect her interests with most non-SADC COMESA members, including Kenya, Uganda, Zaire and Madagascar. This may lead to stiffer regional competition with Zimbabwe.

South African exports to COMESA for the period from 1989 to 1993 are shown in Table 5.6. Exports to COMESA as a proportion of total South African exports grew, largely due to growth in exports to members of COMESA that are also members of SADC. The proportion of exports to non SADC members of COMESA remains approximately 2.5 percent.

Imports into South Africa from the COMESA grew over the same five-year period. (See Table 5.7). In 1989, they accounted for 1.6 percent of South African imports, rising to 2.3 percent in 1993.

Despite the increases in trade between South Africa and southern Africa, both SADC and COMESA countries remain relatively unimportant trading partners. The southern African trading blocks only account for small proportions of South African trade, with the exception of Zimbabwe. Excluding gold, arms and oil, SADC accounts for 10 percent of South Africa's exports and two percent of their imports. Including COMESA increases these proportions to 12 and 2.3 percent, respectively.

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<sup>124</sup>Angola is a major oil exporter, but sells very little to the region, including her neighbors Zambia, Namibia, Zaire and Botswana. Like Angola, Mozambique and Zaire have artificially low intra-regional trade yet are potentially rich, with huge populations. Thus, these countries represent an under-exploited potential for future trade. Nevertheless, South African trade with these countries is comparatively higher than Zimbabwe's with the same countries. This state of affairs was probably caused by the civil war and is likely to be reversed once peace is consolidated.

**Table 5.6. South African Exports to COMESA: 1989-1993 (R million)**

	1989	1990	1991	1992	1993
Angola	18.8	53.2	138	369	263
Burundi	5.2	5.9	10.9	12.0	13.2
Comoros	23.6	21.8	33.1	31.6	36.9
Djibouti	0	0	0	0.4	0.2
Ethiopia	0	1.1	2.2	0.7	3.8
Kenya	10.3	24.3	30	147	205
Lesotho	0.02	0.01	0.04	0.7	0.002
Madagascar	24.1	53.3	42.9	52.8	60.9
Malawi	434.9	419.2	576.5	695.5	591.7
Mauritius	273	315	380	388	471
Mozambique	371.9	462.9	689.3	676.7	961.6
Namibia	0.04	0	0.1	0.3	0.06
Rwanda	0.7	0.4	0.6	7.2	408
Seychelles	41.8	45.7	49.4	60.8	78.5
Somalia	2.7	5.3	2.2	0	1.5
Sudan	10	26.9	6.2	21.3	31
Swaziland	2.1	0.1	0.1	2.4	0.2
Tanzania	3.0	11.1	10.0	25.7	57.7
Uganda	0.9	2.2	0.7	2.9	9.2
Zaire	363	467	307	290	131
Zambia	446.3	530.4	663.4	1111.7	1305.9
Zimbabwe	991.5	1158.7	1600.7	1548.7	1745.2
Total COMESA	3620	3580	4540	5450	6150
Total South Africa	30800	32400	36800	42400	49500
COMESA % Total	9.8	11.0	12.3	12.8	12.4

Source: Holden, Merle, "Economic Integration and Trade Liberalization in Southern Africa. Is there a Role for South Africa?" World Bank Discussion Paper, Number 342, 1996. Quoted with permission. US\$ = 4.5 Rand.

**Table 5.7. South African Imports from COMESA: 1989-1993 (R million)**

	1989	1990	1991	1992	1993
Angola	9.9	0.06	0.02	0.5	1.1
Burundi	0	0.01	0.4	0.03	0.1
Comoros	0.2	0.2	1.0	0.3	0.3
Djibouti	0	0	0.02	0	0
Ethiopia	0.5	0.2	0.3	0.1	0.3
Kenya	17.1	10.5	17.5	23.2	30.2
Lesotho	0.3	0.2	0.36	0.06	0.02
Madagascar	0.4	1.3	2.7	6.6	4.1
Malawi	58.5	81.0	91.0	131.5	159.5
Mauritius	10.8	14.2	14.0	12.8	19.2
Mozambique	17.5	30.4	37.4	47.4	60.3
Namibia	0.07	0.6	0.7	0.59	0.5
Rwanda	0.01	0.9	105	0.1	0.4
Seychelles	0.5	0.3	1.1	0.7	1.0
Somalia	0	0.07	0.02	0	0.01
Sudan	0.4	0.2	0.6	0.3	6.3
Swaziland	0.2	0.06	0.4	0.9	1.3
Tanzania	1.6	2.5	0.95	10.3	21.8
Uganda	0.3	0.08	0.1	0.05	1.1
Zaire	47.6	21.8	12.9	11.0	262
Zambia	5.7	6.3	14.5	40.5	75.5
Zimbabwe	457.4	440.7	471.6	810.6	659.0
Total COMESA	629	612	669	1100	1304
Total South Africa	38682.7	380103.4	42054	46319.6	56124.7
COMESA % Total	1.6	1.6	1.6	2.4	2.3

Source: Ibid.

## **B. FACTORS INFLUENCING ZIMBABWE'S DESIRED TRADE ARRANGEMENTS WITH SOUTH AFRICA AND SOUTHERN AFRICA**

Zimbabwe's future trade relations with South Africa cannot ignore the rest of the southern African region, particularly, South Africa's dominance of SACU and her unilateral protectionist trade policies.<sup>125</sup> The strategy should consider the different levels of economic integration across SACU, SADC and COMESA.

The details of the new SADC trade protocol were not available at the time of this writing. The available SADC literature does not explain how a free trade area will be achieved concomitantly with bilateral arrangements and overlapping SACU, SADC and COMESA membership. The alternative merely observes that harmonization will take place at a progressively higher level of integration within the framework of the whole community.<sup>126</sup> For example, Zambia and Zimbabwe recently announced the imminent finalization of a bilateral trade agreement.<sup>127</sup> The consensus among SACU members is that the union should progress to the common market phase of economic integration.<sup>128</sup> This seems logical, given that the union presently operates as a defacto common market with almost free movement of factors of production, particularly through the migrant labor system. This suggests that the 'catching-up'

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<sup>125</sup>This issue has been discussed in detail in Chapter III.

<sup>126</sup>The SADC Treaty called for among other things, "...deeper economic cooperation and integration *on the basis of balance, equity and mutual benefit*, providing for cross-border investment and trade, and the free movement of factors of production, capital and labor across national borders; and Common economic, political and social values and systems, such as free enterprise, free elections and multiparty systems, respect for the rule of law and the guarantee of human rights" (original emphasis). See Mandaza Ibbo, and Tostensen, Arne, (edited by Emang M. Maphanyane), Southern Africa: In Search of a Common Future, Gaborone, 1994; and "SADC: The Resources, Institutions and Capacity For Integration," Proceedings of the Consultative Conference held in Lilongwe, Republic of Malawi, 1st- 4th February, 1995.

<sup>127</sup>The Post, "Zambia-Zimbabwe to Finalize Trade Agreement," Zambia National www server, Zambia, November 28, 1996.

<sup>128</sup>SADC, "Resources, Institutions and Capacity For Integration," The Proceedings of the Consultative Conference held in Lilongwe, Republic of Malawi, 1st- 4th February 1995.

will of necessity harmonize at a higher level, like say a customs union, common market or economic community, implying that non-SACU members will continue to face trade barriers from South Africa.

Any bilateral agreement implicitly rules out Zimbabwe out-competing South Africa in SACU, which is her de facto market. Concerning SADC, important issues include SADC's tolerance of bilateral trade arrangements and its emphasis on development cooperation and political relationships. This means that important issues may continue to be resolved at the bilateral level, not within the SADC framework. Finally, the strategy should not overlook the asymmetries in GNP, potential market sizes (particularly non-SADC and COMESA countries), the level of development, productive capacity, regional investment opportunities, the nature of imports and exports, and the level of each country's protection.<sup>129</sup>

The following options are open to Zimbabwe:<sup>130</sup>

- ◆ A free trade area within the COMESA, or SADC framework, or an amalgamation of the two, encompassing SACU.
- ◆ Harmonizing bilateral trade relations with South Africa for specific sectors.
- ◆ Continued duplicate and overlapping COMESA and SADC membership with bilateral trade arrangements in specific sectors.

Harmonizing SADC and COMESA as a free trade area would require the rest of the region to 'catch-up' with SACU to form a customs union or common market. SACU member countries cannot revert to a lower level of economic integration (e.g., a free trade area).

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<sup>129</sup>Although the Southern African countries differ in size, income, and population, most of their output is similar.

<sup>130</sup>These are not the only possible options, but in my view, they are the most realistic.

A separate free trade area under SADC or COMESA means continued trade barriers between the SACU and non-SACU SADC until the ‘catch-up’ occurs. This would sharpen competition by the regional countries to enter into competing arrangements with South Africa and/or Zimbabwe, delaying free trade. Each of the possible options has costs and benefits, which should be analyzed.

### **1. Perspectives Regarding Customs Unions, Free Trade Areas and Bilateral Trade Agreements**

The debate concerning the ‘traditional’ Ricardian international trade theory and ‘new’ international trade theory (strategic trade theory) has not been resolved conclusively, as was shown in chapter II. Nevertheless, the composition and patterns of global trade policies suggest that both approaches are relevant in certain circumstances. Chapter II also showed that the Vinerian customs union theory on trade creation and trade diversion is ambiguous. Regional trading arrangements can address existential reality; the level of trade creation and diversion rests on the assumptions made.

The issue is not whether regional economic integration reduces total global welfare, but how a small country, competing with a large trading partner, can choose the most appropriate integration model.<sup>131</sup> In other words, what type of regional trade arrangement would improve Zimbabwe’s welfare.<sup>132</sup> The analysis shall demonstrate that multiple bilateral trade arrangements within the region, or competing free trade arrangements as in the present SACU, SADC and COMESA, are welfare reducing for Zimbabwe and South Africa. Both countries could improve their welfare by

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<sup>131</sup>The extent of trade creation or diversion is irrelevant in this case.

<sup>132</sup>Others have argued that one reason why free trade areas form in the first place is to shift political power centers from importers to exporters. Richardson, Martin, “Endogenous Protection and Trade Diversion,” *Journal of International Economics*, Vol. 34, 3-4, pp. 309-24, 1993.

finalizing a free trade area encompassing the present SACU, SADC and COMESA, augmented by bilateral arrangements on specific issues.

I shall examine the advantages of a free trade area over a customs union, compare a free trade area with bilateral agreements, and then look at an expanding the free trade area vice multiplying free trade areas. Finally, I will look at dynamic gains from trade, with an emphasis on economic growth, technology and investment, and factor mobility.<sup>133</sup>

#### *a. Customs Union Versus Free Trade Areas*

The literature on the superiority of a free trade area over CU has not produced many composite, unambiguous and testable models. Most previous studies focussed on the desirability of regional trade arrangements; they do not consider the most appropriate model given the decision to form a regional arrangement.<sup>134</sup> Previous authors argued that a customs union will always dominate free trade areas, and that a customs union can be extended to include all countries.<sup>135</sup> This conclusion does not explain why free trade areas continue to exist. Frankel and others found that

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<sup>133</sup>The analysis will be microeconomic based. It assumes that the first best solution of global free trade is untenable, largely for political reasons, and is non-discriminatory (MFN) because of non-tariff barriers. Therefore, the choice is within a regional trade arrangement, that is choosing a ‘first best solution’ within the ‘second best.’

<sup>134</sup>See for example, Kemp, Murray. C., and Wan, H. Y., Jr., “An Elementary Proposition Concerning the Formation of Customs Unions,” in Murray C. Kemp, Three Topics in the Theory of International Trade, Amsterdam: North Holland, 1976; and Dixit, Anvinash and Norman, Victor, Theory of International Trade, Cambridge University Press, London, 1980.

<sup>135</sup>See for example, Kemp, M. C., and Wan, H. Y., Jr., “An Elementary Proposition Concerning the Formation of Customs Unions” in M.C., Kemp, Three Topics in the Theory of International Trade, Amsterdam: North Holland, 1976; and Dixit, Anvinash and Norman, Victor, Theory of International Trade, Cambridge University Press, London, 1980. For a review of this literature see Wonnacott, Paul and Wonnacott, Ronald, J., “Is Unilateral Tariff Reduction Preferable to a Customs Union? The Curious Missing Foreign Tariffs,” in American Economic Review, Vol. 71, No. 4, pp. 7-14, September, 1981.

partially eliminating internal barriers in a free trade arrangement would be better than totally eliminating them under a customs union.<sup>136</sup>

De Melo and others have emphasized the comparative institutional issues affecting customs and free trade areas, but they have not concluded which model is better for regional integration.<sup>137</sup> Under scale economies and imperfect competition, a free trade area may lead to lower tariffs to maximize revenues from import volumes. Lower production costs in the lower-tariff country would then help force down tariffs in high-tariff countries. Also, an import tariff set by one country will, if it reduces world prices, affect the rest of the free trade area; gains /losses depend on whether a country imports or exports the goods.

Baldwin and Venables have also shown that if rents from NTBs are not captured domestically, a nation gains from any regional trade arrangement that reduces its average (trade weighted ) tariff equivalent trade barriers.<sup>138</sup> Where the countries are at the same level of economic development, with identical incomes, trade would tend to be intra-industry. Zimbabwe and South Africa have pursued strategic trade policies, have differentiated products and intra-industry trade, but do not meet the criteria of similar development and income levels. Thus, it may be inappropriate to use the Baldwin and Venables model.<sup>139</sup>

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<sup>136</sup>Frankel, Jeffrey A., Stein, Ernesto, and Wei, Shang-Jin, "Regional Trading Arrangements: Natural Or Supernatural?" American Economic Review (AEA Papers and Proceedings), Vol. 86, No. 2, pp. 52-56, 1996. They used the gravity model to analyze bilateral trade on imperfect substitutes. The equation postulates that trade between two countries is proportional to the product of their GNPs, and inversely related to the distances between them.

<sup>137</sup>De Melo, Jaime, Panagariya, Arvind, and Rodrik, Dani, "The New Regionalism: A Country Perspective," in Jaime De Melo and Arvind Panagariya (ed), New Dimensions in Regional Integration, Cambridge University Press, 1993.

<sup>138</sup>Ibid.

<sup>139</sup>The issue of imperfect markets, increasing returns to scale, and strategic trade theory intra-industry trade was dealt with at length in Chapter II.

In a study on Mercosur, Legorburu used the consumer surplus approach to show how a small country could increase national welfare by opting for a free trade area as opposed to a customs union.<sup>140</sup> However, the study was confined to a ‘harmless’ small country among regional giants. It did not consider:

- ◆ The case where the ‘small’ country is also a major regional competitor to the larger country.
- ◆ The effect of third country tariffs on the integrating partners.
- ◆ The overlapping membership of regional trading arrangements at different levels of integration.

Richardson applied the theory of political economy to show that the net effect of forming a regional trade agreement depends on the pattern of external tariffs applied to non-members.<sup>141</sup> Where protection arises endogenously, the welfare reducing effects associated with trade diversion are diminished in the case of a free trade area. A country with a comparative disadvantage compared to the partner will not maintain protection against imports from the rest of the world, since support for protection diminishes as the political influence of domestic industry declines. In his model, tariffs are set to maximize a non-economic, political support function. By isolating terms of trade from tariff effects, he shows that endogenously determined tariffs will fall after forming free trade areas. Consequently, trade diversion becomes trade creation. Thus, under certain circumstances, a free trade area possess all the advantages of a customs union, and does not have the limitations faced by the relatively rigid common external tariffs of a customs union. The model is shown by the identity ( $R = tM$ ), which is written as:

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<sup>140</sup>Legorburu, Beatriz, Impacts of the MERCOSUR Agreement on the Uruguayan Economy, Master’s Thesis, Naval Postgraduate School, 1994. She offers a very comprehensive analysis of tariffs and consumer surplus.

<sup>141</sup>Richardson, Martin, “Endogenous Protection and Trade Diversion,” Journal of International Economics, Vol. 34, 3-4, pp. 309-24, 1993.

$$R = tM = (p - p^*)M^i \quad (1)$$

where  $M^i$  denotes imports of good  $i$  (exports if negative),  $M$  is the  $n \times 1$  vector of non-numeraire imports.  $R$  = scalar and denotes net tariff revenues. If  $B^i$  is the exogenously determined share of revenues that are allocated to capital owners in sector  $i$ , then firms choose Labor ( $L^i$ ) to maximize profits denoted  $I^i$ :

$$I^i = p^i F^i [K, L^i] - wL^i + B^i R \quad (2)$$

The government's objective is to maximize a weighted sum of the utilities of capital owners and workers. Where workers receive a share  $B^w$  of tariff revenues, this is denoted as  $V^w [p, I^w]$ , where  $I^w = \text{income} = wL + B^w R$  and  $L$  denotes the total labor supply in the economy. Full employment is implied.  $V^i [p, I^i]$  represents the indirect utility of  $X^i$ -sector capital owners, the government's objective is to choose  $p$ , given world prices,  $p^*$ , to maximize:

$$G[p, p^*] = \sum_{i=1}^n a^i v^i [p, I^i] + a^w v^w [p, I^w] \quad (3)$$

where  $a^i$  and  $a^w$  are positive constants.  $B^w + \sum_{i=1}^n B^i = 1$ . Demands are all homothetic.

Total imports are given by:

$$\Phi^i [p] I - F^i [\bar{K}^i, L^i] \quad (4)$$

and aggregate income is given by:

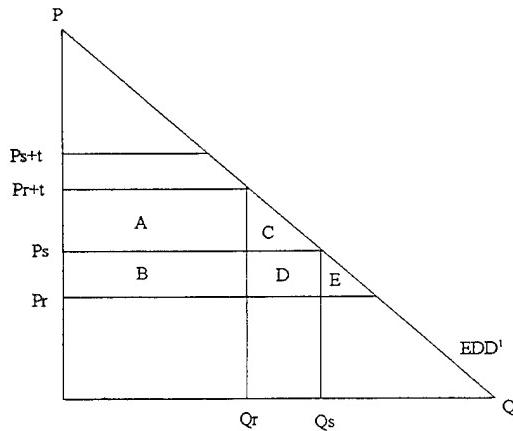
$$I = \omega L^0 + \sum_{i=1}^n p^i F^i [\bar{K}^i, L^i] + R \quad (5)^{142}$$

Using a Richardson model, we can illustrate these propositions. Assume that there are three countries: a small country, Zimbabwe (Z), and two large countries South Africa (S) and the rest of the world (R). All countries produce,

<sup>142</sup> For the full derivation of the function and numerical examples, see Richardson, Martin, "Endogenous Protection and Trade Diversion," Journal of International Economics, Vol. 34, 3-4, pp. 309-24, 1993.

consume and export steel.<sup>143</sup> We also assume that Zimbabwe's steel industry is the most relatively inefficient, followed by South Africa. The price of steel includes transportation and all other transaction costs. At the pre-free trade area equilibrium, all tariffs are non-discriminatory, all imports come from R and the political equilibrium tariff is characterized by the first order condition for maximizing the political support function. Assume further that the Zimbabwean government objective function implies a global maximum at a price for steel between the partner and world price, but less than Zimbabwe's autarky price. Thus, equilibrium tariffs are positive, non-discriminatory but not prohibitive.<sup>144</sup>

Graphically, Zimbabwe's excess demand for steel is illustrated in Figure 5.1. EDD' represents Zimbabwe's excess demand for steel, (imports). Ps and Pr represent the prices in S and R respectively without tariffs. With tariffs, the respective prices are Ps+t, and Pr+t. Since R is the most efficient supplier, Z imports all excess requirements (Qr) from R at price Pr+t. Z's gain in tariff revenue is A+B.



**Figure 5.1. Effect of Flexible External Tariffs on Partner and the Rest of the World**

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<sup>143</sup>A small country is one which cannot affect world prices or the quantity traded by altering its price or quantity.

<sup>144</sup>This assumption is made for each of the three countries.

After forming a free trade area, Z's industry collapses; the country switches imports to S, paying Ps, gaining A+C in welfare, but losing all tariff revenue.<sup>145</sup> The net effect is C-B, which may positive or negative. Trade diversion from R to S has clearly occurred. (The UTR theory suggests that Z would be better-off reducing tariffs unilaterally, for a net gain of C+D+E).

Within a free trade area, all losses associated with diversion can be avoided by reducing tariffs on imports from R to less than autarky (i.e., between Ps and Pr), so that net gain is a+c and the tariff loss is A, with an overall gain of C. A fall in tariffs against R, to between Ps and Pr has no consequences for domestic firms, but yields some tariff revenue.<sup>146</sup> Where Z's steel industry is completely eliminated, there is no incentive to maintain tariffs, since the mere existence of a free trade area or customs union prevents the re-imposition of tariffs on S to make Pr <Ps. If Z were to eliminate all tariffs unilaterally, the country's net gain would be C+D+E , but this is greater than loss in tariff revenue.

Thus, with endogenously determined tariffs, (through the political support function), trade diversion may become trade creation as tariffs are dropped against R. When the price Ps is the same as Pr, then Z should be indifferent and trade diversion is eliminated. As tariffs fall on R, so that  $Pr+t < Ps+t$ , all trade goes to R. Depending on the governments political support function at  $Ps=Pr$ , tariffs may actually fall, such that  $Pr+t < Ps$ .

This may force S to reduce the price of steel, an advantage not available under a customs union. The free trade area merely started the decline of the domestic

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<sup>145</sup>Zimbabwe's industry is no longer protected against imports from S, and the industry starts to decline via the free trade area through the political endogeneity of protection, leads to tariffs against R to fall.

<sup>146</sup>There is no clear incentive for the domestic industry to lobby for maintaining a high tariff, nor are there any new domestic employment effects associated with the second round of tariff reduction.

industry, but this continues by the second round of tariff reductions. As industry declines, so will its lobbying power and level of protection granted by the government.<sup>147</sup>

Under a customs union, this fall in tariffs would be subject to the consent of all partners, with lobbying and counter-lobbying by the respective industries and labor.<sup>148</sup> If the customs union common external tariff is set above Ps, then Z would buy all steel from S. While domestic firms are indifferent to the source of imports, industry in S would prefer that Z purchases from S; they would oppose any preferential treatment for non-members under a customs union.

There would be no difference for the most efficient producer between a customs union or free trade area; Z would naturally buy all its excess requirements from S. Where transport and transaction costs add to prices, proximity may influence Z to buy from closer sources. Tariff revenues from S that have been lost to Z are irrelevant because both a customs union and a free trade area eliminate internal barriers. The partial loss of tariff revenue may be compensated for through increased efficiency under either a free trade area or customs union. In this scenario, the tariffs against the non-partner are not totally eliminated, hence enabling Zimbabwe to retain tariff revenue earnings. Another consideration is possible retaliation by the partner. Where the both countries have the flexibility to reduce external tariffs unilaterally, this increases free trade with the rest of the world, hence improves global welfare.

This highlights the role of unilateral trade liberalization within a free trade area, but not in lieu of regional trade arrangements. For a small competitor country, such as Zimbabwe, a free trade area with unilateral tariff reduction would

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<sup>147</sup>Where tariffs are granted solely for domestic political support, there is no explicit channel by which firms in the partner countries could influence the process or retaliate.

<sup>148</sup>Even in the case of South Africa and her SACU partners, negotiations on common external tariffs have taken up to two years without an agreeable solution. Mail and Guardian, "New Trade Data to Exclude SA's Neighbors," April 21, 1997.

be preferable to either a customs union, or a unilateral tariff reduction in lieu of a regional trade arrangement. This argument can be extended to cover any number of goods, particularly intermediate goods, and for any number of countries. It also partially explains why trade may not increase within a free trade area in all circumstances.

Where circumstances permit, external tariffs should remain flexible downwards for a country joining a regional trade arrangement; this would allow the smaller competitor country to take advantage of imports from more efficient countries. The Richardson model would, in my view, apply whether trade is intra or inter-industry, and subject to constant returns or increasing returns.

The main criticism of a free trade area is that it introduces complex rules of origin.<sup>149</sup> Free trade areas are accompanied by complex elaborate rules of origin and content requirements which are difficult to monitor. Since rules of origin under a free trade area have no explicit revenue or production cost impact on the domestic economy, a country advocating strict rules of origin disguise protection of other intermediate sectors, imposing high welfare costs. However, in a customs union (CU), lower tariff members are able to raise tariffs above pre-union levels. GATT rules state that common external tariffs should be no higher than average of members before the union. Furthermore, free trade areas also give reform-oriented small countries flexibility to pursue their own trade policies, thus minimizing the risk of escalating trade restrictions.

On the other hand, a customs union obviates autonomy on trade policy. Nations may end up with barriers that are not nationally optimal, possibly benefiting

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<sup>149</sup>De Melo, Jaime, Panagariya, Arvind, and Rodrik, Dani, "The New Regionalism: A Country Perspective," in Jaime De Melo and Arvind Panagariya (ed), New Dimensions in Regional Integration, Cambridge University Press, 1993; and Baldwin, Richard E., and Venables, Anthony, J., "Regional Economic Integration," in Gene M. Grossman and Kenneth Rogoff (ed.), Handbook of International Economics, Vol. III, Elsevier, 1995.

by reducing external tariffs. In a CU, reform oriented states can get ‘sucked in,’ toward higher tariffs, if lobbies favoring common high external tariffs are strong. When imports start to enter through low tariff countries, this puts pressure on other countries to lower tariffs. This contributes to the WTO spirit of global free trade. It may not necessarily be injurious to the free trade area as it enhances efficiency. Finally, at the macroeconomic level, problems of supporting inflation may arise in the Southern African customs union, given the desperate inflation level shown in Table 4.7.

The counter arguments are that the least protective country in a customs union, can force the other members to lower tariffs. A customs union may also dilute protectionist lobbies in free trade areas, where lobbying is still at the national level.

The actual costs of rules of origin are not easy to quantify, but they clearly introduce transaction costs not present in a customs union. In some respects, forming a customs union reduces global welfare; free trade areas leave more flexibility to reduce tariffs without having to get a consensus from the other partners.

#### *b. Bilateral Agreements Versus Free Trade Areas*

Currently, most countries have sectoral bilateral trade agreements with South Africa and/or Zimbabwe.

Balassa has raised several important points concerning sectoral agreements:<sup>150</sup>

- ◆ Whereas simultaneous integration provides for the compensating changes in all sectors, trade barriers in other sectors lead to adjustments in the liberalized sectors alone, resulting in distortions in the economy.

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<sup>150</sup>Balassa, Bela, The Theory of Economic Integration, Richard D., Irwin, Inc., 1961.

- ◆ Each step in the process results in a temporary equilibrium of prices, costs and resource allocation. Production decisions are made on the basis of prices that are relevant only in the given phase of integration.
- ◆ Coordinating monetary and fiscal policy is difficult under sectoral agreements, since different economic policies may influence commodity and factor prices, importing inflation.
- ◆ Non-economic problems like conflicts of interests between consumers and both exporting and importing sectors may dictate that the ultimate policy is determined by those with the most influence.

It has been argued that bilateral arrangements have advantages over larger groupings, including quicker agreements, more easily monitored costs, and more easily verified compliance with the agreement.<sup>151</sup> De Melo and others have argued that the fewer the partners the better. This optimizes both the economic and political objectives.<sup>152</sup> This argument fails to take into account that bilateral relations are not mutually exclusive; a country may enter into several of them, potentially covering the same general sectors. Even where all the bilateral agreements are consistent (as suggested by Zimbabwe), this is unnecessarily wasteful.<sup>153</sup>

Bilateral, sectoral agreements have been justified on the grounds that free trade under a broad multi-country agreement will favor more economically developed countries at the expense of the less developed. In Southern Africa,

<sup>151</sup> See Richardson, Martin, "Endogenous Protection and Trade Diversion" in Journal of International Economics, Vol. 34, 3-4, pp. 309-24, 1993. He uses the example of the US-Canada free trade area which went beyond the past and current GATT agreement.

<sup>152</sup> De Melo, Jaime, Panagariya, Arvind, and Rodrik, Dani, "The New Regionalism: A Country Perspective," in Jaime De Melo and Arvind Panagariya (ed), New Dimensions in Regional Integration, Cambridge University Press, 1993.

<sup>153</sup> A series of consistent bilateral agreements in lieu of a wide free trade area increases the transaction costs for the exporters and importers. In any event, if they were all consistent, the simpler method would be to make one trade agreement, instead of several. Furthermore, there is no guarantee that Zimbabwe's 'consistent' bilateral agreements will not be rivaled by those involving South Africa, nor is it clear from the direction of trade data whether Zimbabwe could provide an incentive to stop the other countries from concluding superior bilateral agreements with South Africa.

Zimbabwe, together with South Africa and Kenya, are considered potential benefactors. While Zimbabwe may be concerned with full integration with South Africa, countries like Zambia, Malawi, and Mozambique, see Zimbabwe as a threat.<sup>154</sup>

The most illuminating argument on the effects of multiple bilateral trade agreements has been given by Wonnacott (1991).<sup>155</sup> Wonnacott has shown that competing bilateral agreements largely benefits the hub, at the expense of the spokes. If South Africa (hub) were to sign separate bilateral trade agreements with Zimbabwe and Zambia (spokes), South African firms would avoid trade barriers in both Zimbabwe and Zambia; the spokes would only have free access to South Africa, not to each other's markets. Zimbabwe and Zambia's firms would also lack access to less expensive raw materials that would allow them to compete efficiently with South Africa in all regions including in South Africa, Zambia and Zimbabwe, and in the rest of the world. The more spokes South Africa 'takes in,' as she is currently doing, the more it erodes previous gains to the spokes. The first country to sign a bilateral agreement with South Africa suffers as more spokes are joined. This discrimination would be avoided if the whole region entered a regional free trade arrangement.<sup>156</sup> South Africa's benefit from bilateral agreements comes largely at the expense of the rest of the region:

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<sup>154</sup>Omotunde, Johnson, E. G., "Economic Integration in Africa: Enhancing Prospects for Success," in Journal of Modern African Studies, Vol. 29, No. 1, pp. 1-26, 1991.

<sup>155</sup>Wonnacott, Ronald J., The Economics of Overlapping Free Trade Areas and the Mexican Challenge, C. D. Howe Institute, Toronto, 1991. The terms 'hub' and 'spoke' are also attributable to Ronald J. Wonnacott. They refer to a situation where a dominant country concludes bilateral trade agreements with several smaller countries in lieu of a formal free trade area encompassing all countries.

<sup>156</sup>It has already been argued that South Africa's conclusion of a free trade agreement with the EU would cost her SACU partners about R 1 million per year. See Electronic Mail & Guardian , "Free Trade With EU Will Hurt SA's Neighbors," Mail and Guardian, South Africa, (30 October 1996 and 05 November 1996); and Standard Chartered Bank, "Africa Quarterly Review," Standard Chartered Bank, Harare, Zimbabwe, October, 1996.

- ◆ Only South Africa would enjoy free trade with all her neighbors.
- ◆ By expanding her preferential trade agreements, she expands markets and relative competitiveness.
- ◆ The preferences she gets make her attractive for foreign direct investment (FDI).

On the other hand, opting for a free trade area gives several benefits:

- ◆ Comparative advantage and economies of scale are greater in a free trade area than in bilateral networks. Bilateral agreements would discriminate against Zimbabwean exports, making it difficult for domestic Zimbabwean firms to remain competitive.
- ◆ A multi-country free trade area would better protect national interests by ensuring appropriate treatment of EPZs (subsidiaries). It would prevent countries from artificially attracting industry and distorting trade and investment.
- ◆ A free trade area would ensure that new and competing bilateral arrangements do not ‘supersede’ existing bilateral agreements.
- ◆ Where other trading partners are moving toward free trade, there is a high cost of being an outsider when trading partners are liberalizing their trade.

With imperfect competition, industry location will be skewed towards nations with large markets. In a hub-spoke arrangement, firms located at the hub will have better access to consumers than those located in the spokes. This creates the same access effect, helping the hub to have more industry, and possibly higher wages than all spokes.

One possible reason countries join hub-and-spoke arrangements is that powerful countries like South Africa can sign bilateral agreements with or without general regional consensus. But this may also damage the bigger country’s national interests:

- ◆ Separate bilateral agreements might give hub firms an incentive to lobby against foreign competition, not only in the hub(s), but also in the spoke countries. This would introduce trade distortions, rent-seeking and waste.

- ◆ There are bound to be inconsistencies in the various bilateral agreements.
- ◆ Bilateral agreements introduce political and economic costs, particularly accusations of regional hegemony.
- ◆ Since South Africa and Zimbabwe accept countries into different bilateral agreements, discrimination is bound to arise, thus distorting terms of trade.
- ◆ The hub itself loses control if the spokes sign their own hub-and-spoke arrangements that reduce the hub to another spoke.
- ◆ Hub-and spoke arrangements tend to be sectoral, introducing distortions in the economy.
- ◆ Decisions by the leading countries in the region may set the precedent whereby all regional countries compete to gain better access to the South Africa's markets.

Thus, countries signing bilateral trade agreements with dominant partners in lieu of free trade arrangements invariably reduce their own welfare as they compete with other countries to establish the best bilateral agreements. The same hub-and-spoke arguments can be extended to Zimbabwe's own bilateral arrangements with other smaller regional partners, except Zimbabwe is a junior competitor to the larger hub (South Africa); Zimbabwe could be reduced to another 'spoke' in a chain of hub-and-spoke relations, with most of the benefits accruing to South Africa. It is not the small size of the spoke that is critical, but the future potential trade loss.

*c. Competing Regional Trade Arrangements (SACU, SADC, COMESA)*

The third possibility is continuing SACU, SADC, and COMESA as separate overlapping regional trade organizations. The proximity theory postulates that given sufficient demand for variety or differentiated goods, countries will enter into trade arrangements with their neighbors. Where transportation costs are higher

than the lowered duty, no trade will take place with distant countries.<sup>157</sup> For example, Botswana and South Africa have to date declined to join COMESA; Mozambique and Lesotho have decided to quit the organization. They argue that COMESA is unwieldily and that there is limited intra-COMESA trade.

The benefits from intra-COMESA trade are presently enjoyed by a few countries, notably Zimbabwe, Kenya and Mauritius, as shown in Table 5.1. Mozambique and Lesotho would not suffer any immediate losses for withdrawing from COMESA.<sup>158</sup> The proximity argument may be true for Mozambique and Lesotho in COMSEA. It may also be true for Zimbabwe in the sub-Saharan African context. In any event, bilateral benefits tend to be short term. In the long -run, the opportunity costs of this approach may be high, for example, the subsequent build up of costs in bilateral or future potential trade that may be damaged, as is the present case with the 1964 trade agreement with South Africa which tied Zimbabwe's trade to that country at the expense of the rest of the world.<sup>159</sup>

Wonnacott (1996) has also shown that expanding free trade areas is more welfare increasing for the countries than separate overlapping free trade areas, since each free trade area thinks it is liberalizing trade, (but only in itself), yet to those outside the trade arrangement, trade barriers to its own exports remain intact.<sup>160</sup>

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<sup>157</sup>Krugman, Paul R., "Is Bilateralism Bad?," in Elthaman Helpman and Assat Razin, (ed.), International Trade and Trade Policy, MIT Press, Cambridge Massachusetts, pp. 9-23, 1991a. See also Perroni, Carlo and Whalley, John, The New Regionalism: Trade Liberalization or Insurance?" National Bureau of Economic Research, Cambridge, Massachusetts, 1994.

<sup>158</sup>Zimbabwe would suffer more than any other country if it were to withdraw because its trade with COMESA is significant, but more importantly, it would leave a vacuum, which South Africa would gratefully fill.

<sup>159</sup>For a lucid expansion of this argument, see Wonnacott, Ronald, J., "Free Trade Agreements: For Better or Worse?," American Economic Review, Vol. 86, No. 2, pp. 63-66, 1996.

<sup>160</sup>Wonnacott, Ronald J., "Free Trade Agreements: For Better Or Worse?" American Economic Review, AEA Articles, Vol. 86, No. 2, pp. 63-66, May 1996. He found that an expanding free trade arrangement not only generates welfare increasing trade diversion, but also reverses the previous negative trade diversion.

It is not possible in this thesis to test the applicability of this theory, nor is it easy to quantify the proximity theory, but if such an argument holds, then countries like Kenya would not figure in Zimbabwe's regional strategy. Also, due to differing market sizes and income levels, one may suspect that the hub-and-spoke argument would not apply where transportation costs are prohibitive. But evidence from Table 5.6 suggests that, in southern Africa, it is the level of development that is correlated with large mutual trade, not geography.

Others may argue that any limited free trade organization would of necessity be a form of hub-and-spoke with the rest of the world. However, where trade with the rest of the world is an option, the expansion of free trade may be a step toward global free trade.<sup>161</sup> South Africa's invitation to conclude a free trade agreement with Europe is estimated to cost her SACU partners approximately 1 million Rand in revenue.<sup>162</sup> Yet, if the regional trade arrangement were a free trade area, they could quickly adjust their own trade policies to cope with this problem. Furthermore, any moves that liberalize trade in one way or another increase efficiency and global welfare.

Under an expanding free trade area, each of the countries would expect to augment its gain from preferential bilateral trade with a larger neighbor by:

- ◆ Getting additional gains from tariff free trade with all the members of SACU, SADC and COMESA.
- ◆ Minimizing duplication of effort and waste.

Wonnacott's theory lacks a quantitative measure of the actual benefits and losses in hub-and-spoke arrangements, but this does not dispute the conclusion

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<sup>161</sup>Ibid.

<sup>162</sup>Electronic Mail & Guardian , (30 Oct 1996 and 05 November 1996), "Free Trade With EU Will Hurt SA's Neighbors," Mail and Guardian, South Africa; and Standard Chartered Bank, "Africa Quarterly Review," Standard Chartered Bank, Harare, Zimbabwe, October, 1996. R 4,5=approx 1 US\$.

that multiplying regional trade arrangements or bilateral trade agreements in lieu of wider free trade agreements is an inferior option. Possible policy conclusions imply that hub-and-spoke agreements, in lieu of free trade areas, should be temporary, with a definite phase out date. The exception is issues that are inherently bilateral, like common rivers, hydro-electric projects, cross-border movements. Also, free trade arrangements should not be re-negotiated each time a new member wishes to join. This may undermine the original members' position.

From the three options considered, the free trade area option seems strongly persuasive. Any of the alternatives above could predestine Zimbabwe to perpetual trade deficits and unending quarrels with South Africa and other neighboring countries over trade issues. Worse still, it might lead to unnecessary and costly trade wars.

## **2. Free Trade and Economic Growth**

Most regional trade models examine short term or static benefits of regional integration. The analysis only considers the effects of free trade under the assumptions of constant factor endowment and resource allocation, with constant returns to scale and diminishing returns to factors of production. In the long term, the benefits and costs of regional free trade can be measured in terms of the likely effects of free trade on individual countries.

The neo-classical model of economic growth was developed by Robert Solow.<sup>163</sup> The model assumes constant returns to scale, diminishing returns to factors of production and exogenous technological progress. Per capita production changes arise from changes in the capital-labor ratio, or capital-land ratio. Due to diminishing returns, the marginal benefits decrease as capital increases. Growth in output continues until the reallocation of resources has been completed. Solow's model can be expressed using a Cobb-Douglas production function;  $Q_t = A t K_t^{\alpha} L_t^{1-\alpha}$ .

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<sup>163</sup>Solow, Robert, "Technical Change and the Aggregate Production Function," Review of Economics and Statistics, Vol. 39, pp. 312-320, 1957.

Where Q=output, K=capital, L=labor, A=exogenous technological progress, and t denotes time. Differentiating with respect to K, L, we get,

$$\ln Q = A + \ln a * K + \ln 1 - a * L \quad (6)$$

The model assumes constant returns and exogenous technical progress. Thus, it indirectly explains growth within the model. In reality, it is difficult to disembody technological progress from capital and labor. The model also postulates a trend towards convergence in productivity across countries over time. This is not consistent with reality.

The Solow model also postulates efficiency and marginal cost pricing; in reality, innovation requires monopoly profits. The assumption of constant returns to factors is not realistic, as this does not capture the spill-overs of knowledge and R&D, and other externalities like learning by doing, licencing, etc.

The new growth models have built on the neo-classical growth model to incorporate increasing returns to scale, externalities, and endogenous technology and human capital formation. The mainstream of the new growth theory models was provided by Romer,<sup>164</sup> and further developed by Lucas<sup>165</sup> and by Grossman and Helpman.<sup>166</sup> As Grossman and Helpman point out, new researchers do not start from scratch, but build on what is already in use. Productivity in the final goods depends on the number of intermediate goods, 'n' and the fixed costs of its production. This is a critical factor in explaining increasing returns.

The models of economic growth can thus be classified into two broad categories: those with external economies of scale and those with internal economies

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<sup>164</sup>Romer, Paul, M., "Increasing Returns and Long-Run Growth," Journal of Political Economy, Vol 94, pp. 1002-1037, 1986a.

<sup>165</sup>Lucas, Robert, E., "On the Mechanics of Economic Development," Journal of Monetary Economics, 22, pp. 3-42, 1988.

<sup>166</sup>Grossman, Rene, M., and Helpman, E., "Endogenous Innovation in the Theory of Growth," Journal of Economic Perspectives, Vol. 8, No. 1, pp. 23-44, Winter 1994. See also Romer, Paul M., "The Origins of Endogenous Growth," Journal of Economic Perspectives, Vol. 8, No. 1, pp. 3-22, Winter 1994.

of scale. In the first category, it is assumed that private investment in capital increases productive knowledge. This spreads through positive externalities to other sectors of the economy or other countries.<sup>167</sup> Thus, externalities offset the diminishing returns to scale, such that the production function becomes

$$Q_t = B_t K_t^b L_t^{1-a} \quad (7)$$

where  $B_t$  is the basic knowledge that grows exponentially, and  $a+b$  is the output-capital elasticity--which is different from the share of capital. The model assumes increasing returns to factors, particularly through internalized learning by doing and positive externalities. When  $a+b$  is equal to or greater than 1, per capita output can grow without experiencing any diminishing returns to capital.

Later models incorporate learning by doing and increasing levels of technology through spill-overs. Human capital growth is influenced by previous accumulation and its own utilization.<sup>168</sup> In a closed model, this would be limited to the knowledge that labor accumulates within the country; in an open economy, the spill-overs come from trading partners and investors.

The internal economies of scale models incorporate fixed costs in the production of fixed inputs, R&D and differentiated products under monopolistic conditions.<sup>169</sup> The model can be given by:

$$Q_t = Z_t^{1-a-b} K_t^a L_t^{1-a} \quad (8)$$

where  $Z$ =aggregate measure of intermediate inputs. Innovation sustains both capital accumulation and growth, as opposed to the invisible hand as postulated by the neoclassical model.

<sup>167</sup>Romer, Paul, M., "Increasing Returns and Long-Run Growth," Journal of Political Economy, Vol. 94, pp. 1002-1037, 1986a.

<sup>168</sup>Ibid. See also Lucas, Robert, E., "On The Mechanics of Economic Development," Journal of Monetary Economics, 22, pp. 3-42, 1988.

<sup>169</sup>Grossman, Rene, M., and Helpman, E., "Endogenous Innovation in the Theory of Growth," Journal of Economic Perspectives, Vol. 8, No. 1, pp. 23-44, Winter 1994. See also Romer, Paul, M., "The Origins of Endogenous Growth," Journal of Economic Perspectives, Vol. 8, No. 1, pp. 3-22, Winter 1994.

These models seem to offer a more realistic explanation of conditions in developed countries. However, they could be useful for South Africa and Zimbabwe, given their comparatively high level of industrialization, as shown by their export structures in Tables 5.1 and 5.4. These models also imply that many states export those goods for which they have higher technology and import those goods where they have lower technology.

What the models suggest is that some policies can influence integration and growth.<sup>170</sup> Residents of free trade countries benefit from knowledge and technology externalities, with free trade facilitating speedy dissemination. Free trade also exposes firms to international markets, forcing them to innovate at an international level, rather than nationally. By expanding the market size, economies of scale also dictate R&D incentives. A country that lacks the size and technical expertise to support global-wide R&D will only specialize in those industries for which it has the capacity. However, conclusions on the choice between a customs union and free trade area cannot be drawn solely on the basis of models without empirical testing.<sup>171</sup>

Nevertheless, the new growth models provide some useful insights, both for a single country and for the region as whole. In relation to southern African regional integration, the model has implications for government's role in the economy and tariff structures. Government could encourage R&D and investment in capital stock to improve factor productivity. Liberalizing trade does not guarantee that

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<sup>170</sup>Grossman, Rene, M., and Helpman, E., "Endogenous Innovation in the Theory of Growth," Journal of Economic Perspectives, Vol. 8, No. 1, pp. 23-44, Winter 1994.

<sup>171</sup>Howard Pack has observed that while the new models are satisfying and do not rely on an unexplained source of technological change, they are still not empirically developed in their explanatory power of sustained differences between countries. Pack, Howard, "Endogenous Growth Theory: Intellectual Appeal and Empirical Shortcomings," Journal of Economic Perspectives, Vol. 8, No. 1, pp. 55-72, Winter 1994.

entrepreneurs sufficiently invest in human capital and new technology on their own, where there are obvious externalities to others.

External tariffs should not be so high they discourage technology and knowledge dissemination, yet they should be high enough to protect whatever knowledge and technological advantages the country or region already has. Given the different levels of technological development between South Africa and Zimbabwe, a unilateral intra-regional tariff reduction, in lieu of a free trade area, would do more harm than good to Zimbabwe. South Africa's comparatively developed R&D infrastructural base would make it easy for human capital accumulation, relative to Zimbabwe. Zimbabwe would preserve her interests well by directing her resources where she has a comparative advantage or where competitive advantages can be created vice the Southern African region, for example, in human capital accumulation, agriculture and light manufactures, and liberalize the import of those inputs used in export production. Import markets should be liberalized quickly, and not selectively, to avoid distortions, and not delay the problems.<sup>172</sup>

The design of tariff structures could take either of two approaches.<sup>173</sup> One approach is to reduce the tariff on intermediate capital goods while delaying reducing it on consumption goods. This provides breathing room to adjust. This is the approach that Zimbabwe took in 1997. The disadvantage is that it may introduce distortions in the economy, particularly investment incentives. The other option is to annually cut all tariffs across the board by a uniform rate. This approach is simple and transparent, and high tariffs are reduced faster in absolute terms. However, it does not consider third countries, preferred sectors, and assumes perfect competition.

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<sup>172</sup>Hoekman, Bernard, and Djankov, Simeon, "Effective Protection and Investment Incentives in Egypt and Jordan During the Transition to Free Trade With Europe," World Development, Vol. 25, No. 2, pp. 281-291, Elsevier Science Limited, 1997.

<sup>173</sup>Ibid.

### **3. Foreign Investment and Dissemination of Technology**

Full trade liberalization will have many implications for labor and capital, both local and international. The latter is crucial for small, less developed countries like Zimbabwe, as it brings technology externalities. It should be noted that there are many factors that influence investment, including the climate, incentives, interest rates, and availability of services. These transaction costs need to be equalized before foreign investment moves from one country to another. Increasing trade may affect growth through its investment in human and physical capital, and through the rate of investment and rate of improvement in factor productivity. To date, investment prospects have not been bright in Zimbabwe.<sup>174</sup> On the other hand, South Africa has a negative integration index (Mauritius, Zimbabwe, Kenya and Zaire were the only states with positive indexes in eastern and southern Africa). Yet, South Africa is still attracting most investments to the region.<sup>175</sup> The explanation could lie in imperfect competition, services, and the ‘hub’ status that South Africa enjoys. It may also reflect future potential as perceived by investors, vis-a-vis the region.

What is critical for the regional trade arrangement is to address factor productivity, incomes and factor payments. Balassa has argued that by making labor and capital highly mobile, factor equalization may be accelerated.<sup>176</sup> Generally,

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<sup>174</sup>Standard Chartered Bank, Africa Quarterly Review, 1996; Mail & Guardian News, May 17, 1996; See also “Foreign Investors Stay Away From Zimbabwe,” Mail & Guardian News, March 19, 1997. Foreign investors, are also said to be wary of investing in Namibia, preferring Zambia and Mozambique instead. In the case of Zimbabwe, the reasons cited are unstable domestic climate, like the budget deficit and inflation. There is only a 50% implementation rate of new investment. Nevertheless, Export Processing Zones seem to be the going momentum in Zimbabwe. See PANA, April 18, 1997.

<sup>175</sup>The speed of integration indices measure the degree of economic liberalization in law and order, political stability, infrastructure, institutional capacity, and enabling investment environment. For details, see Standard Chartered Bank, “Africa Quarterly Review,” Harare, September 1996.

<sup>176</sup>Some factors of production are difficult to move, for example land and mineral resources. In addition, other factors like transportation and information may be difficult to move. See Balassa, Bela, The Theory of Economic Integration,....1961.

where capital is immobile, labor would tend to move. In this case, it will move to South Africa. Capital moves if labor is immobile. It is one question to ask whether trade equalizes factors under *ceteris paribus* assumptions; it is quite another question to ask how technological progress and other dynamic changes affect factor prices.

More recent studies by Norman and Venables have revealed that trade in goods alone will not equalize factor prices, but that a small reduction in the cost of international migration could induce large scale labor migration to a labor scarce economy. Migration would allow the country to become a large scale exporter of labor-intensive goods. Hence, there is an incentive for factors to move internationally.<sup>177</sup> In another study, Venables (1995) has shown that contrary to the Balassa theory of factor equalization, economic integration under imperfect markets can widen factor price differences, as an agglomeration of forces come into play.<sup>178</sup>

A free trade area that makes countries compete in reducing external tariffs would reduce average transaction costs, hence improving allocative efficiency. The fall in transaction costs may better compensate for lost tariff revenues; the greater the economies of scale, the greater the incentives to concentrate investment where firm has better infrastructural advantages and services. The hub arrangement fosters this tendency; it makes sense to invest in the hub so the firm has duty free access to many countries.<sup>179</sup>

Hoekman and others (1997), suggest that an effective way to encourage investment is to treat all investors equally, without any limitations regarding equity,

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<sup>177</sup>Norman , Victor, D., and Venables, Anthony, J., "International Trade, Factor Mobility and Trade Costs," The Economic Journal, 105 pp. 1488-1504, November 1995.

<sup>178</sup>Venables, Anthony, J., "Economic Integration and Location of Firms," American Economic Review, Papers and Proceedings, (AEA), pp. 296-300, January 1995.

<sup>179</sup>Ibid. Hoekman Bernard, and Djankov, Simeon, "Effective Protection and Investment Incentives in Egypt and Jordan During the Transition to Free Trade With Europe," World Development, Vol. 25, No. 2, pp. 281-291, Elsevier Science Limited, 1997.

shares or stakes operations.<sup>180</sup> Foreign direct investment in peripheral countries, taking advantage of lower labor costs, may help compete with the stronger countries.<sup>181</sup>

The conclusions from trade theory literature and factor productivity are rather ambiguous, and as noted by Deardorff; trade theory lacks composite and simple models to capture the effects of both technology and preferences.<sup>182</sup> What is clear is that trade barriers should be lowered with as many countries as possible, especially regional countries. At the same time, transaction costs of investment should be reduced to the minimum possible level. Since most services cannot be traded across borders, it may be necessary to open the services sector to foreign investment. Investments in services reduce transaction costs and increase productivity in the economy. Zimbabwe should not expect free trade to be an end all panacea which will create a free flow of investment and new technology, unless they reduce transaction costs. The government should take a more proactive role to reduce the transaction costs.

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<sup>180</sup>Ibid. They recommend that where the national interest to safeguard particular sectors is too strong, a transparent exception rule is necessary, without making it so long as to send a weak signal to foreign investors.

<sup>181</sup>It does not necessarily follow that foreign investment will lead to more competitiveness than domestic firms in all sectors, as demonstrated by the example of Kenyan textile manufacturers. See Omotunde, Johnson E.G., "Economic Integration in Africa: Enhancing prospects For Success," The Journal of Modern African Studies, Vol. 29, No. 2, pp. 1-26, 1991.

<sup>182</sup>Deardorff, Alan, V., "Fireless Firwoes: How Theorems Can Interfere With The Theorems of International Trade," Journal of International Economics, 20, pp. 131-142, 1986.

## **VI. CONCLUSIONS AND RECOMMENDATIONS**

Throughout the century, international trading systems have been characterized by two apparently conflicting trends: growing protectionism and globalization of free trade. In an effort to maximize economic welfare gains from expanding production, countries have attempted to expand their own exports, while at the same time restricting imports. In addition, capital and labor have continued to relocate internationally order to reduce production and marketing costs. Domestic policies have become largely influenced by international trading arrangements. As the debate on the pros and cons of each strategy continues, the distinction between pure free trade and pure protectionism has become less clear, resulting in conflicting signals to governments and the private sector alike.

Since the end of World War II, the trend toward regional trading blocs and the reduction of quantitative restrictions with more transparent barriers has increased. In the Third World, pre-1980s regional trading arrangements were characterized by import substitution, but the recent wave has been accompanied by export oriented strategies and efforts to attract foreign investment and technology.

Like most LDCs, Zimbabwe's experience with regional trading arrangements has been mixed. From 1965 to the early 1980s, the country had relative success with bilateral trade arrangements, notably with South Africa, but the trading relations did not deepen to higher levels of economic integration. While South Africa became a captive trading partner, she gradually reduced the preferences offered to Zimbabwe, eroding the latter's terms of trade and competitiveness. As frustration with the slow progress of GATT increased amid oil crises-induced debt, southern Africa saw the creation of two initially complementary, but gradually competing, regional trading arrangements, namely SADCC and COMESA (of which Zimbabwe was a founding member); but both excluded Zimbabwe's main trading partner, South Africa.

COMESA's objective was free trade while SADCC's goal was cooperation for development. As the latter transformed into SADC, the distinction between the two organizations blurred. In spite of the good intentions at the time, Zimbabwe is now caught in a regional trade predicament: membership in two overlapping regional trade arrangements (both with as yet to be realized free trade), and South Africa's reluctance to restore preferential trade status, which has worsened trade relations with Zimbabwe's largest trading partner and competitor for regional trade. The situation is further complicated by the existence of a South African dominated customs union and series of competing bilateral trade agreements involving South Africa, hence diminishing Zimbabwe's competitiveness in the region.

In Chapter I, it was pointed out that the objective of this study was to examine Zimbabwe's bilateral trade strategy with South Africa, and her continued participation in overlapping regional trading arrangements using the customs union and free trade area frameworks. In the following sections, I summarize the main conclusions of the research, offer recommendations as to Zimbabwe's most appropriate strategy, and suggest areas for future research.

#### **A. THEORETICAL FOUNDATIONS OF INTERNATIONAL TRADE AND THE TREND TOWARD ECONOMIC REGIONALIZATION**

As discussed in Chapter II, the theoretical foundations of international trade and regional trading arrangements range from the highly protective mercantilist view of the 16th century, through the classical economists who believed in free trade based on comparative advantages resulting from inherently endowed factors of production and resources, to the new international trade school of thought that rejects the notion of naturally endowed comparative advantage, arguing that competitive advantages can be created to redress imperfect markets.

The recent international trade theory debates wavered between perfectly competitive free trade to the advocacy of strategic government intervention in areas

like R&D, subsidies, export incentives and import restrictions to give domestic firms advantages over their competitors. It was shown that none of the approaches are flawless. Each cover some important aspects of international trade, but fail to present a complete blueprint to guide governments wanting to grapple with difficult domestic and international macroeconomic imbalances. As a result, most governments have found utility in the strategic approach, while advocates of free trade, like GATT and the WTO, continue to prefer the traditional free trade approach with minimum government involvement.

The theory of regional trading arrangements was shown to be equally controversial, starting from Jacob Viner's trade creation and trade diversion hypothesis, to recent contributions which have shown that earlier studies tended to focus on border issues while neglecting more complex non-tariff aspects, such as non-tariff barriers, subsidies, competition policy, agricultural policy, harmonization of economic policies, standards, etc. Therefore, most theoretical guidelines on regional trade arrangements have tended to be situational and depend on the type of organization formed, the economic characteristics of the participant countries, their location and the ultimate objectives. It was also shown that, for small countries like Zimbabwe, regional trade arrangements can be an alternative, not to free trade, but to growing protectionism abroad and inefficient import substitution.

Later in the chapter, it was demonstrated that in spite of GATT's progress toward globalization of free trade, preference for regional trading blocs has increased since WWII. Arguments for and against this tendency have been equally controversial, with some arguing that regionalization of trade is a necessary development to address the slow progress in GATT talks, while others insist that the proliferation of regional trading blocs has been instrumental in frustrating liberalization of global trade. Among the cited problems with GATT, the important ones are:

- ◆ Stalled negotiations led to pessimism regarding multilateral arrangements and the rise of regional blocs. The few countries that liberalized trade unilaterally on a most-favored-nation (MFN) basis, mainly in conjunction with a reorientation of domestic policies, did so in the context of regional, bilateral, or sectoral initiatives.
- ◆ GATT was seen as part of the US versus those of the then USSR hegemonic interests, and incapable of dealing with the new world realities. While it is relatively easier to reduce tariffs, it has been more difficult to resolve the issue of non-tariff barriers (NTBs), and to extend GATT to cover other areas like agriculture and services.

Compared to the difficulty in reforming the GATT, regional blocs are supported because:

- ◆ Regional trading blocs allow countries and companies to adapt to numerous economic changes at a more manageable level.
- ◆ It is easier to negotiate a bilateral or regional agreement than a multilateral one, thus circumventing the problems associated with non-tariff barriers. Others have argued that the GATT itself was borne out of several regional blocs.

Proponents of GATT tend to base their views on concepts such as multilateralism, free trade, comparative advantage and economic liberalism, which is consistent with the traditional concept of comparative advantage. Those who back regional blocs favor free trade in certain cases but also favor economic nationalism, regionalism and bilateralism, ideas that are consistent with strategic/managed trade theories and neo-mercantilism.

However, these two trends have brought to light the inherent contradictions between multilateralism and regionalization of trade. GATT is based on nondiscrimination and the reliance on tariffs vice quotas for protection, while regional trading blocs are founded on the principle of regional preferences and do discriminate against non-members, even if they are signatories to the GATT.

The changes in world trade relationships and economic structures have been accompanied by changes in the role of governments, especially in intervention and

fostering certain competitive trading relationships justified on the grounds of market failure to bring about balanced development. It was shown that governments' desire to mobilize and nurture productive factors in the face of entry barriers, and the need to redistribute benefits from trade and technology, have been strong factors in increasing regional economic integration. Active government participation has also been justified because most successful European and Asian countries seemingly relied on large scale state intervention in leading edge sectors, including subsidized terms of credit, provision of infrastructure, suppression of wages and federal research and development to correct 'market imperfections.'

With the growing regionalization in developed countries, particularly the EU, and the formation of NAFTA, less developed countries found themselves with little choice but to consolidate their own arrangements so as to increase their bargaining power in future global trade and development issues. In LDCs, Zimbabwe and South Africa being no exceptions, governments played key roles not only in starting new industries, but also planning and controlling economic development through public sector enterprises.

Two contemporary examples of regional trading arrangements were examined, one a common market model and the other a free trade approach. The EU and NAFTA case analysis illustrated that economic integration is a long and complex process which requires concrete but achievable goals. While each of the two arrangements has different objectives and depth (on issues like tariffs, movement of factors, coordination of economic policies), national interests have not been ignored. The EU's approach of deeper integration leaves members inflexible to act unilaterally as they achieve successively higher levels of integration. In contrast, NAFTA, with shallow arrangements, gives members flexibility to enter into other extra-regional arrangements and to coordinate national macroeconomic policies.

## **B. REGIONAL TRADING ARRANGEMENTS IN SOUTHERN AFRICA**

Chapter III examined the three regional trade arrangements that concern either Zimbabwe, South Africa, or both. These were SACU, COMESA and SADC, which relate to customs union, common market, and free trade via economic cooperation for development models respectively. Each model was analyzed in terms of objectives, progress and limitations.

SACU is characterized by the overwhelming domination by south Africa over the economies of the other four smaller members. The agreement provides for free internal trade (excluding agriculture), common external tariffs, a common customs pool and a revenue sharing scheme to compensate the members for allowing South Africa to make their economic policy decisions. The lack of meaningful industrialization in the smaller SACU members and the disagreements over the customs revenue sharing arrangements have been a source of conflict within SACU. It was seen that the agreement inherently suffers from a conflict of interests, with South Africa seeing it as a source of restricting imports while the other countries see it as a source of revenue. Instead of deepening integration to achieve a common market status, SACU has tended toward more shallow arrangements with all the members joining competing regional trade arrangements.

The free trade area organization involving Zimbabwe is the Preferential Trade Area for Eastern and Southern African countries (PTA). It was formed in 1981, through the efforts of the UN Economic Commission for Africa, and specifically excluded South Africa for political reasons. The PTA was later transformed into COMESA, and its treaty explicitly recognizes establishing of an economic community as its ultimate goal. COMESA's main objectives are:

- ◆ To attain sustainable growth by promoting harmonious trade.
- ◆ To promote joint economic development in all fields and joint macroeconomic policies to foster relations among members.

- ◆ To promote cross border investment and joint promotion of R&D.
- ◆ To strengthen the bargaining position with the rest of the world.
- ◆ To achieve a free trade area by 2005, with a customs union 10 years later.

Among COMESA's achievements were the establishment of a Clearing House in Zimbabwe and PTA Trade bank in Burundi. The main limitation of COMESA were low intra-regional trade and unending arguments about the common list of qualifying goods. There was also dissatisfaction by some members about the continued asymmetric trade in favor of the more developed members, particularly Kenya and Zimbabwe.

SADCC is a regional development organization, whose main objective was to reduce dependence on South Africa, and its transformed version, SADC (which now includes South Africa). SADCC was formed in 1980 by nine southern African countries, including Zimbabwe, all but one of which later joined the PTA. SADCC's main objective was to promote and coordinate regional developmental projects. The reasons for this emphasis were that:

- ◆ Most SADCC members wanted to tackle industrial incapacity, and pure trade could not address their immediate problems including acute foreign exchange problems.
- ◆ All SADCC members had bad experiences with free trade zones in the 1960s; the arrangements ensured that all the benefits accrued to the relatively more developed member.

SADC has gradually shifted emphasis toward intra-SADC trade, cross border investment, and free movement of factors of production, in addition to development.

The SADC protocol provides for a free trade area in eight years, through phased tariff reduction. In this respect, SADC overlaps with COMESA, both in its membership and goals. SADC however encourages bilateral trade measures and the principle of reciprocal preferences. It was noted that SADC, being the only regional trade organization that includes both South Africa and Zimbabwe, is the main focus

of most countries of the sub-region. Notable as well was the skewed intra-SADC trade in favor of South Africa, and to a lesser extent Zimbabwe, hence the scramble by most SADC countries to conclude bilateral trade agreements with South Africa.

Other recent SADC developments include:

- ◆ That the gains achieved by members through SACU should not be reversed, but harmonized at a higher level of integration.
- ◆ The recognition that no future meaningful arrangement can exclude South Africa upon which all the countries are economically dependent.
- ◆ The signing of the SADC Trade Protocol in March 1997.

The South Africa-EU proposed free trade arrangement has been a cause for concern for all SADC countries, as they fear trade diversion from such an arrangement.

The Zimbabwe-South Africa preferential trade arrangements dating back to 1964 were also looked at. It was noted that while the agreement was relatively harmonious until 1980, post-independent Zimbabwe has faced increasing unilateral revisions from South Africa, resulting in a highly skewed balance of trade in favor of the latter. Several weaknesses were cited in the agreement, most notable being that:

- ◆ The agreement is not based on the principle of reciprocity, and has not been updated to include new products or revise quota quantities.
- ◆ Most quotas were specified in value instead of volume terms making them vulnerable to devaluations and inflation.
- ◆ Zimbabwean exports to South Africa involve primarily consumption goods, which not only competed with South African products, but tended to be demand elastic. On the other hand, South Africa's exports to Zimbabwe were mostly intermediate and capital goods, and relatively demand inelastic.
- ◆ The existence of a customs union (SACU) and competing bilateral agreement between South Africa and other regional countries limit Zimbabwe's potential to compete with her partner in those countries with separate agreements with South Africa.

- ◆ The ongoing bilateral trade negotiations to restore and expand the old agreement have not produced meaningful progress, except agreeing to reduce textile tariffs to from 90% to 30% over 5 years.

### C. MACROECONOMIC INDICATORS

In Chapter IV, various macroeconomic indicators of all SADC countries and some important non-SADC COMESA members were analyzed. The analysis revealed huge differences between South Africa and the rest of the Southern African countries. The main differences highlighted includes the following:

- ◆ Total GNP and per capita income levels and market size.
- ◆ Cost, scale, growth and structure of production.
- ◆ General level of social and economic development and employment.
- ◆ Purchasing power parity and inflation.
- ◆ Level of technology, investment and savings rates.
- ◆ External aid dependence and indebtedness.
- ◆ Differing natural resource endowment.
- ◆ Differing public sector participation ratios.
- ◆ Historical trade patterns and policies.

South Africa is the dominant member of both SACU and SADC, and sells a significant proportion of her exports to the region, mostly to Zimbabwe, but almost all her major imports come from outside the region. While South Africa is Zimbabwe's largest trading partner, the region is also important for two-way trade. On the other hand, for South Africa, Zimbabwe is the main export market in the region, but the regional total is a small proportion of total exports. In some measure, Zimbabwe's trade also exhibits similar triangular trade patterns as in South Africa, differing only in magnitude.

South Africa protects her domestic industries through high tariffs, prohibitions, quotas, especially on capital, agricultural and manufactured sector imports. Some South African tariffs are still well above those recommended by the WTO, but some

effort has been taken to reduce them over a 12 year period. Exports are promoted through an array of incentives in R&D, subsidies and cash payments to certain sectors, which has been a source of complaints not only from Zimbabwe, but also from other regional countries. On the other hand, Zimbabwe has all but cut export promotion subsidies, and import duties have been drastically reduced.

The different trade policies in the two countries have contributed to the delays in finalizing the trade agreement with Zimbabwe and the SADC free trade area protocol. The irony in the SADC free trade area negotiations is that while most of the SADC countries favored more rapid removing trade barriers, South Africa preferred a longer period to allow the other members to 'adjust.' However, the recent signing of the SADC trade protocol and the re-start of the bilateral trade negotiations were positive signs.

#### **D. ZIMBABWE IN SOUTHERN AFRICAN REGIONAL TRADE ARRANGEMENTS**

Zimbabwe finds herself in a dilemma as to what strategy to adopt in handling her trade relations in southern Africa, especially in light of the deteriorating terms of trade with South Africa, her main trading partner-competitor in both mutual and regional trade. This trade strategy is crucial for Zimbabwe's economic survival.

Three sets of possibilities were considered:

- ◆ A SADC free trade area vice harmonizing into a SADC customs union.
- ◆ Choice between SADC and COMESA, or to catalyze the unification of the two overlapping organizations into a broader free trade area.
- ◆ Continuing the bilateral trade arrangements.

While the traditional approach assumes perfect competition and constant returns, the new trade theory assumes market failures. In reality, Zimbabwe-South Africa trade is explained by both approaches. Trade in clothing, textiles, footwear

some light manufactures and agricultural goods is intra-industry, while that in capital and most intermediate goods is inter-industry.

The research examined the possible costs and benefits of choosing the most beneficial option and the likely impact on Zimbabwe's choice of technology, foreign investment, economic development and welfare. The welfare benefits were measured by the flexibility to pursue independent extra-regional trade policies, resultant imports at lower prices, particularly production inputs, while retaining some tariff revenue earning capacity from such imports. The method used was to construct a model of free trade and customs unions to compare the possible welfare effects of politically endogenous external tariffs in a free trade area and customs union.

While essentially biased toward the strategic trade theory, this approach is useful in explaining issues not adequately covered by traditional and new trade approaches to choices among regional trade arrangements. The analysis showed that if the southern African countries could achieve free trade with endogenously determined external tariffs, Zimbabwe (as a small-competitor country) would most likely benefit from a free trade area than would otherwise be the case under a customs union. Whereas a customs union dominated by South Africa might enable Zimbabwe to increase her competitiveness in the South African market, and the rest of the SADC countries, Zimbabwe could lose her extra-regional markets due to the likely higher common external tariffs. A free trade area which gives Zimbabwe the flexibility to import essential production inputs would improve her intra-industry competitiveness in South Africa and the rest of the world.

Such free trade area benefits could also be extended to the rest of SADC countries, including the smaller SACU countries, provided the issue of rules of origin is resolved early enough to allow the smaller countries to choose their export niches. It is plausible that the findings of this study could be applied to weaker-competitor countries in similar regional trading quagmires around the world, for

example Argentina vice Brazil, Ghana and Senegal vice Nigeria, or New Zealand vice Australia. Therefore, the issue that needs to be carefully addressed in any free trade arrangements are the complex rules of origin, as this imposes limitations on Zimbabwe's ability to attract foreign investment and technology to specialize in those goods which South Africa might consider a threat to her own industries.

The further entrenchment of bilateral trade arrangements between unequal trading partners in an environment of intra-industry competitive trade could, in the long run, worsen Zimbabwe's position vice South Africa. The main argument was that a series bilateral agreements by many countries would allow South Africa to compete on more favorable terms in all the spoke countries, but the spokes themselves would only be competitive in South Africa, and not in each other's markets as no liberalization would have taken place. In fact, they could only compete indirectly via South Africa. It was also argued that the strategic positioning of South Africa as hub would attract all the foreign investment and technology to that country, as only South Africa would have free trade with all the countries of southern Africa. Nevertheless, it was pointed out that while South Africa would reap more benefits from a series of bilateral agreements, she would also be worse-off than if she were to conclude a free trade agreement with all her neighbors.

Further discussions of the continued existence of SACU, SADC and COMESA and the spreading of bilateral trade agreements, showed that while multiplying regional trade arrangements would benefit those members who belong to both organizations, this would divert trade from the rest of the world to South Africa and hinder global free trade. However, the benefits to South Africa were not clear if that country were to maintain restrictive trade policies, especially high tariffs. If the SADC and COMESA were to merge into a broader free trade area, taking into account transaction costs involved in trading with distant countries, both Zimbabwe and South Africa would be better-off if this flexibility enabled them to import goods

from the rest of the world at lower prices. Any alternative will predestine Zimbabwe to perpetual trade deficits, disagreements with south Africa and other neighbors over trade policies and unnecessary and costly trade wars.

#### **E. RECOMMENDATIONS FOR ZIMBABWE'S REGIONAL TRADING PARTICIPATION**

Given the relative costs and benefits of the customs union and free trade areas, bilateral and free trade areas, and competing regional trade arrangements, the persuasive arrangement seems to be a free trade area involving all present eastern and southern African country members of SADC and COMESA. Bilateral trade agreements should, where unavoidable, be temporary, with definite phase out dates. As long as South Africa seeks free trade arrangements outside the region while maintaining high external tariffs, the move toward a customs union and common market should be resisted, as this seems to offer Zimbabwe fewer benefits. To speed up the agreement, the free trade area could cover only those goods which her trading partners do not consider critical for their own economic survival. Once the free trade area is in place, Zimbabwe could negotiate for free trade arrangements with other groups outside the region, like the EU and ECOWAS, to provide her with less expensive production inputs and minimize restrictions on her exports.

#### **F. RECOMMENDATIONS FOR FUTURE RESEARCH**

This study only looked at the possible benefits of a free trade area and customs union using tariff barriers and non-measurable hub-and-spoke theory, and did not examine the impact of a phased tariff reduction strategy to be adopted by Zimbabwe, let alone SADC and COMESA. Further research on the ex-ante and ex-post tariffs of either SADC and COMESA could reveal what strategy would be most appropriate in reducing external tariffs and effectively deal with South Africa's strategic trade policies. Also, the utility of a geographically-dispersed COMESA countries was not

examined. Perhaps using the proximity theory one could examine the optimum size of the regional grouping in eastern and southern Africa.

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